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BEFORE THE ARIZONA CORPORATI

IN THE MATTER OF THE APPLICATION)
OF FAR WEST WATER AND SEWER)
COMPANY, AN ARIZONA CORPORATION,)
FOR A DETERMINATION OF THE FAIR)
VALUE OF ITS UTILITY PLANT AND)
PROPERTY AND FOR INCREASES IN ITS)
RATES AND CHARGES FOR UTILITY)
SERVICE BASED THEREON.)

) DOCKET NO.
) WS-03478A-05-0801

At: Phoenix, Arizona

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(Pages 397 through 582, inclusive)

Arizona Corporation Commission
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1 BE IT REMEMBERED that the above-entitled and
2 numbered matter came on regularly to be heard before the
3 Arizona Corporation Commission, in Hearing Room 1 of said
4 Commission, 1200 West Washington Street, Phoenix,
5 Arizona, commencing at 9:33 a.m. on the 20th day of July,
6 2006.

7

8 BEFORE: TEENA WOLFE, Administrative Law Judge

9

10

11 APPEARANCES:

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23

24 LESLIE J. FOLDY
Certified Reporter No. 50041

25

1 ALJ WOLFE: Let's go back on the record.

2 Good morning.

3 MR. SHAPIRO: Good morning.

4 ALJ WOLFE: Mr. Shapiro, you may continue with
5 this witness.

6 MR. SHAPIRO: Thank you.

7

8 CROSS-EXAMINATION RESUMED

9

10 Q. (BY MR. SHAPIRO) Good morning, Mr. Moore.

11 A. Good morning.

12 Q. We really just have one more issue to cover
13 today, Mr. Moore. That's the RUCO recommendation
14 regarding rate-case expense. Let's see if there are a
15 few things we can at least agree on.

16 You would agree with me that a class B sewer
17 utility can't raise its own rates?

18 A. Correct.

19 Q. No utility regulated by the Arizona Corporation
20 Commission can raise their own rates?

21 A. Right.

22 Q. In order to get utility -- in order to get rate
23 increases, the utility must come to the Arizona
24 Corporation Commission?

25 A. Correct.

1 Q. It must file the items required by the
2 Commission's rules, which include the A through H
3 schedule and testimony supporting the application and
4 schedules?

5 A. Correct.

6 Q. And they also must address any insufficiencies
7 in the application that are found by staff?

8 A. Correct.

9 Q. They'll have to notify their customers as
10 directed by the Commission?

11 A. Correct.

12 Q. In this case you would agree with me that we
13 have three notices: a notice of the filing, a notice of
14 public comment, and likely another notice that new rates
15 are in effect; correct?

16 A. Correct.

17 Q. Utility -- the utility in a rate case must
18 respond to data requests or object and obtain a ruling by
19 the administrative law judge?

20 A. Correct.

21 Q. Okay. As a rebuttal, Mr. Bourassa testified
22 that Far West responded to over 200 data requests from
23 staff and RUCO. Do you disagree with that?

24 A. Subject to check.

25 Q. That's Mr. Bourassa's rebuttal at page 17, if

1 you'd like to check later.

2 A class B sewer utility will typically
3 participate in four rounds of prefiled testimony after
4 its application is filed, and by that I mean analyzing
5 the other parties' filings and then filing their own?

6 A. This begins to get into the discretionary area
7 of whether or not there is sufficient grounds for
8 settling or, you know, truncating the process. But, you
9 know, that is the process.

10 Q. Has RUCO contacted the company about a
11 settlement in this case to your knowledge?

12 A. I think Mr. Bourassa maybe bantered around an
13 idea or two.

14 Q. To your knowledge, nothing precludes RUCO from
15 contacting the company's representatives and saying, hey,
16 we'd like to discuss a settlement of the rate-case
17 issues?

18 A. No.

19 Q. Nothing prevents staff from doing that as well?

20 A. No.

21 Q. You would agree that the utility is likely to
22 need to conduct some of its own discovery to better
23 understand the positions of the other parties?

24 A. Yes.

25 Q. You would agree that our class B utility we're

1 talking about is going to have a hearing before the
2 Corporation Commission?

3 A. Yes.

4 Q. The hearing in this case will hopefully go three
5 days, maybe four?

6 A. Okay.

7 Q. We spent most of the first two days on
8 cross-examination of the company's witnesses; correct?

9 A. Yes.

10 Q. The utility is now, at least in the water and
11 sewer case, typically required to file two closing
12 briefs?

13 A. Correct.

14 Q. And to file final schedules after the hearing?

15 A. Yes.

16 Q. And in this case we've been asked to prepare an
17 itemization of rate-case expense as well by Judge Wolfe?

18 A. I believe so, yes.

19 Q. In order to prepare the closing briefs, the
20 utility is required to purchase transcripts so that they
21 can make record cites?

22 A. Yes.

23 Q. If I told you that the transcripts in this case
24 are estimated to cost about \$4,000, would you have any
25 reason to disagree with that figure?

1 A. I'll take your word for it.

2 Q. We have to pay them something for sitting here
3 all day with us, don't we?

4 And then there is a process after the hearing
5 and briefing that involves analysis of a recommended
6 opinion and order, potentially the filing of exceptions,
7 and then coming to an open meeting before the Commission;
8 correct?

9 A. Yes.

10 Q. So this process that we just walked through from
11 application to open meeting, we can agree that this is
12 generally the process for class A and B water and sewer
13 utilities to obtain new rates?

14 A. Outside of the alternative of trying to, you
15 know, mitigate the amount of testimonies and costs, if
16 there was a narrow amount of issues that could be settled
17 and then present an agreement in front of the open
18 meeting, it's a method of completing the process, yes.

19 Q. You would agree with me that narrowing the
20 issues in the manner you just suggested requires the
21 concurrence of all of the parties?

22 A. I think there's been settlement agreements where
23 RUCO has put it -- has not agreed to.

24 Q. And I apologize. You're right. It's a
25 potential that two parties could settle some issue and

1 another party could object. But you have to have
2 somebody else agree to settle one issue?

3 A. Okay.

4 Q. This process we went through, this is a process
5 that is determined by the Corporation Commission;
6 correct?

7 A. Correct.

8 Q. It's not the utility that decides that process?

9 A. Well, there is the outline, but, like I -- I'll
10 reiterate again, there is a process to --

11 Q. I think what you're trying to say, Mr. Moore, if
12 I can help, is that we have a process. How long the
13 process takes, how complicated it is, the utility does
14 have some role in the later part, but they don't dictate
15 the actual process itself. Is that fair enough?

16 A. Okay.

17 Q. Can we also agree, Mr. Moore, there is a certain
18 embedded or minimum cost in participating in all of these
19 steps that we went through from the filing of an
20 application to an open meeting?

21 A. Like a threshold, it went tickety-boo.

22 (Discussion off the record.)

23 Q. (BY MR. SHAPIRO) Mr. Moore, I'll remind you
24 there is somebody in the operating room listening to us
25 today.

1 Yes, no matter how complicated the case is,
2 there is still a hearing, there is still an open meeting,
3 there are still rejoinder filings or rebuttal filings?

4 A. Correct.

5 Q. No matter how many intervenors we have, there
6 are still -- those processes take their course?

7 A. Um-hum.

8 Q. Same is true, even if we don't have a large
9 number of issues in dispute, we still go through those
10 steps?

11 A. Correct.

12 Q. Now, in this case, you didn't really look at the
13 amount of rate-case expense being incurred by the
14 company, did you?

15 A. I did send out a data request to try and, you
16 know, get a list of how the 160,000 was arranged to, and
17 it wasn't forthcoming, so I went to -- my second method
18 was comparables, complexity, number of issues.

19 Q. But RUCO was being provided copies of invoices
20 for supporting the company's requested rate-case expense
21 as it was being incurred; right?

22 A. I believe I only received the initial response,
23 data request 103, where there was a list of Fennemore
24 Craig's receipts. And I never received an update.

25 Q. Did you ever request any further information?

1 A. I believe there is a standard question in the
2 data request that says please update on any.

3 Q. All right. We'll certainly verify whether that
4 was updated.

5 So you asked the data request, and if I remember
6 correctly, that was introduced yesterday. In that data
7 request, the company indicated that the \$160,000 was the
8 preliminary estimate of its consultant at the beginning
9 of the case; correct?

10 A. Basically, it was -- I could read it, it's an
11 estimate, and there is no hard numbers to verify it.

12 Q. At the time a rate case is filed, you certainly
13 don't know how much you're going to incur, do you, what
14 you're actually going to incur?

15 A. In other rate cases, there has been a budget,
16 you know, time for discovery, time for hearing, you know,
17 cost per person and stuff. They've broken it down to
18 verify or to substantiate their rate-case expenses, yes.

19 Q. But that would be an estimate at the beginning
20 of the case; correct?

21 A. Yeah, and I think the company is willing to
22 stipulate to the \$160,000.

23 Q. Right.

24 A. So if there was a budget or an estimate for
25 that, to verify it and choose the reasonableness of it.

1 Q. Well, in this case, staff and RUCO will have a
2 broken-down itemization of the company's actual expense
3 incurred through a particular date when the company files
4 that per Judge Wolfe's request; correct?

5 A. It's a little late to analyze it after the
6 hearing.

7 Q. You can't verify after the hearing whether or
8 not the company incurred \$13,000 for copying costs when
9 we file an itemized list of the charges?

10 A. Well, the fair and reasonable determination, you
11 know, may come into question.

12 Q. Well, that's always the determination you have
13 to make. I mean, the company doesn't -- in any rate
14 case, the utility doesn't know at the time of the hearing
15 its total rate-case expense, does it?

16 A. There is a lot of money that is incurred up
17 until the rejoinder testimony that is known.

18 Q. Correct. But we don't know how much the hearing
19 costs until we have the hearing?

20 A. Well, three days would have been a good
21 estimate.

22 Q. And the company will actually have actual
23 charges by the time it files an itemization to show what
24 actually was incurred; right?

25 A. Right.

1 Q. Do you have your rebuttal testimony there?

2 A. Surrebuttal?

3 Q. Direct.

4 A. Direct. Yes.

5 Q. If you could turn to page 17. You described
6 this -- and the question is: This is the analysis you
7 went through to make RUCO's recommended level of
8 rate-case expense?

9 Isn't that what it says at the top?

10 A. Basically, yes.

11 Q. And again, there is nothing in here in this
12 analysis that addresses or analyzes the company's actual
13 rate-case expense incurred in this case?

14 A. No. That information isn't available.

15 Q. Okay. The Arizona American and Arizona Water
16 Company cases that you referred to on page 17, those
17 involve the filing of one application for multiple water
18 or wastewater systems; correct?

19 A. Correct.

20 Q. And as a whole, all of those systems went
21 through the process that we discussed today from
22 application to open meeting?

23 A. Each district had its own set of schedules.

24 Q. And its own set of rates?

25 A. And its own set of discovery. There was data

1 requests.

2 Q. But there was one hearing for all of the Arizona
3 water systems that were subject to that rate case?

4 A. Okay. Yes.

5 Q. So no individual water system or district, as
6 you use the term, had to bear the cost of that, of the
7 entire process. That cost was spread among all the
8 systems?

9 A. Correct.

10 Q. Arizona American, Arizona Water Company, and
11 Southwest Gas, you would agree they all have in-house
12 regulatory staff that works on rate cases?

13 A. You worked on the Arizona American.

14 Q. That's true, Mr. Moore, but I don't get to
15 testify. I might like to, but.

16 A. They did use outside consultants.

17 Q. But they also used inside. Mr. Stevenson was
18 the person that Mr. Bourassa mentioned yesterday. He was
19 both a witness and oversaw the rate case, didn't he?

20 A. Right.

21 Q. Arizona Water Company has in-house accounting
22 staff that works on rate cases?

23 A. Correct.

24 Q. And Southwest Gas has both in-house accounting
25 staff and an in-house lawyer that handles their rate

1 cases?

2 A. Correct.

3 Q. And you would agree that the rate payors are
4 paying the cost of that staff through operating expenses?

5 A. Correct.

6 Q. You would agree that Far West Sewer Company did
7 not have in-house regulatory staff that handled this
8 case?

9 A. They did not, no.

10 Q. They hired Mr. Bourassa and the law firm of
11 Fennemore Craig to handle this rate case for them?

12 A. Yes.

13 Q. And do you know whether there are any costs for
14 Mr. Gary Lee, who was, I guess, an expert witness in this
15 case that are part of rate-case expense?

16 Let me ask it this way. Have you seen any costs
17 for rate-case expense included by Mr. Lee to this date?

18 A. No.

19 Q. Now, for RUCO, we have seen in the courtroom
20 Mr. Pozefsky, Mr. Rigsby, Ms. Diaz-Cortez, and yourself
21 involved in this case; correct?

22 A. Correct.

23 Q. I assume probably Mr. Wakefield had some role in
24 RUCO's presentation of its position, assisting in some
25 fashion?

1 A. As did the director.

2 Q. Okay. So that would be six people from RUCO who
3 had some involvement in this case?

4 A. Knowledge of it, yes.

5 Q. As well as you have a paralegal who assists with
6 the case as well?

7 A. No such luck.

8 Q. Isn't there a Ms. Gamble who sends out data
9 request responses and those things?

10 A. Okay. Never heard her addressed as a paralegal.

11 Q. I'm sorry. I thought that was her title.

12 MR. POZEFSKY: So the record is clear, she is a
13 secretary, not a paralegal.

14 THE WITNESS: Sorry about that.

15 Q. (BY MR. SHAPIRO) It doesn't make her role less
16 valuable.

17 For staff, we've seen Crystal Brown, Mr. Liu,
18 Mr. Irvine, Mr. Carlson, Mr. Fox, Mr. Layton, and
19 Ms. Finical participating in this hearing; correct?

20 A. Correct.

21 Q. We can assume probably additional staff people
22 have been involved?

23 A. Correct.

24 Q. So all of the people doing the job for staff and
25 RUCO, all those folks are essentially doing the work that

1 Mr. Bourassa and Fennemore Craig are doing for Far West?

2 A. Correct.

3 Q. Of all the people that are working on the rate
4 case, only Mr. Bourassa and Fennemore Craig record the
5 amount of time and the amount of costs incurred to do
6 that work; correct?

7 A. You mean in a final billing that will be --

8 Q. You can't tell me how many hours you've spent on
9 this case, can you?

10 A. No.

11 Q. Or anybody else from RUCO?

12 A. No.

13 Q. It's only the company -- the company's
14 consultants that record their time and record how much it
15 costs to send out copies and those things?

16 A. Could you repeat the question?

17 Q. Yeah. It's only the company's personnel that
18 record their time, how much time they spend, and how much
19 cost is incurred for both the time and for other tangible
20 items?

21 A. I would -- I don't know if I'm qualified to say
22 if the Commission, but -- records their time on a per-job
23 basis, but you're correct that you do.

24 Q. You don't?

25 A. We don't.

1 Q. When you worked at the Commission, did you keep
2 track of the time you spent on a rate case?

3 A. No.

4 Q. So you would agree with me that only Far West
5 has to justify the recovery of the expenses it has to
6 incur in a rate case?

7 A. Correct.

8 Q. Would you also agree with me that Far West is
9 the only party in this case with a direct financial
10 incentive to keep their costs down?

11 A. If they get dollar-for-dollar recovery, then the
12 incentive is less.

13 Q. How many cases have you seen where a utility
14 recovered every dollar it incurred for rate-case expense?

15 A. I know in years gone past that there was no
16 adjustments made to rate-case expenses.

17 Q. But that would be whether the Commission
18 adjusted the amount requested. If the utility incurs
19 more than it asks for, then, right away, they haven't
20 recovered dollar for dollar; correct?

21 A. If the original estimated amount in the
22 application was correct and there was no adjustment to
23 it, then the company would have recovered their expenses.

24 Q. And if in this case when we turn in the
25 itemization we can support \$200,000 of rate-case expense

1 incurred, and the Commission awards 160, the company will
2 not recover dollar for dollar, will they?

3 A. Correct.

4 Q. In fact, any amount the company incurs, it
5 doesn't recover dollar for dollar immediately. That
6 amount is spread out over a period of time?

7 A. Correct.

8 Q. Five years in this case?

9 A. Correct.

10 Q. You would agree that the time that the company
11 pays Mr. Bourassa's firm or my firm, they don't know
12 whether they're going to recover those costs; correct?

13 A. Correct.

14 MR. SHAPIRO: Thank you, Mr. Moore.

15

16 REDIRECT EXAMINATION

17

18 Q. (BY MR. POZEFSKY) Good morning, Mr. Moore.

19 A. Good morning.

20 Q. Let's start with property tax. I just have a
21 few questions on property tax.

22 Mr. Moore, wasn't it the Water Utilities
23 Association working with ADOR that came up with a formula
24 using historical inputs?

25 MR. SHAPIRO: Objection. I believe that goes

1 beyond the scope of any question I can recall asking in a
2 cross-examination. In fact, I specifically didn't ask
3 questions about the formula itself, Your Honor.

4 MR. POZEFSKY: If I may respond, Your Honor.

5 ALJ WOLFE: Yes.

6 MR. POZEFSKY: My response is the entire
7 cross-examination questioned the validity of RUCO's using
8 the formula. All I'm doing is rehabilitating our
9 position on why using the formula with historical inputs
10 is valid.

11 MR. SHAPIRO: I think we talked about RUCO's
12 position on the company's use of proposed revenues, but
13 that's fine, Your Honor. We'll withdraw the objection.

14 ALJ WOLFE: Go ahead.

15 Q. (BY MR. POZEFSKY) You can answer the question
16 as to --

17 A. Could you repeat the question?

18 Q. Sure. Wasn't it the Water Utilities Association
19 working with ADOR that came up with a formula using
20 historical inputs?

21 A. Yeah. That's part of that famous memo that was
22 written by the ADOR, the directive, and it states that
23 the Water Utility Association and the ADOR had reached an
24 agreement, and the reason that they had the meeting was
25 to reduce the controversy and establish a methodology

1 that would allow them to reduce or -- what is the -- the
2 new valuation methodology will assist the utilities in
3 future dealings with the Arizona Corporation Commission
4 regarding projections of future property tax.

5 And this is the crux of the property tax
6 calculation, is to adhere to the -- this directive. And
7 if it's done according to the directive, then the
8 adjustment or the calculation matches the assessment.

9 Q. And isn't it the same water utilities that do
10 not want to adhere to the formula using historical
11 inputs?

12 MR. SHAPIRO: Objection. There are no water
13 utilities in this case, and I don't know what water
14 utilities -- but to argue the Water Utility Association
15 somehow took a position and every utility is bound before
16 the Commission is frankly just inappropriate.

17 MR. POZEFSKY: I'll withdraw the question, Your
18 Honor.

19 ALJ WOLFE: Thank you.

20 Q. (BY MR. POZEFSKY) Mr. Moore, you just read
21 something, and so the record is clear, before you should
22 be what is marked RUCO's Exhibit No. 11; correct?

23 A. Correct.

24 Q. And can you identify that?

25 A. That is this directive from the Arizona

1 Department of Revenue, property tax division, to provide
2 direction on how to calculate your property tax.

3 Q. And --

4 MR. SHAPIRO: Mr. Pozefsky, can we have a copy
5 of RUCO-11, please?

6 MR. POZEFSKY: Oh, I'm sorry.

7 Q. (BY MR. POZEFSKY) Just one more question on
8 this. Mr. Shapiro, Mr. Moore, asked you yesterday about
9 the forward-looking -- the formula that is used with
10 historical inputs and how, in fact, that is
11 forward-looking, and to the extent this memo addresses
12 that, can you explain that, Mr. Moore?

13 A. Well, it specifically states the property tax
14 will be computed by multiplying the average of the three
15 previous years of recorded gross revenues of the company
16 by a factor of two.

17 Q. And that's your understanding on how the formula
18 using historical inputs is forward-looking; correct?

19 A. Correct.

20 Q. Mr. Moore, we know how important the matching
21 principle is to Mr. Bourassa. Does the company's
22 property tax methodology using projected revenues adhere
23 to the matching principle?

24 A. No. It establishes a level of expense in the
25 test year for a liability that would not incur until

1 November 2008. So they would be able to collect revenue
2 that is greater than the amount of expense they have to
3 pay.

4 Q. Let's just go to rate-case expense, Mr. Moore.
5 You went through the process described by Mr. Shapiro.
6 Do you recall those questions?

7 A. Yes.

8 Q. Mr. Moore, can the process be shortened or
9 abridged?

10 A. Yes. As I suggested, you know, there have been
11 cases that I've been on where there have been settlement
12 agreements after the direct testimony was filed, and that
13 process was truncated and went straight to open meeting.

14 Q. If the parties, Mr. Moore, agree on an issue,
15 the process is shorter than if they disagree on the
16 issue; correct?

17 A. Oh, yes.

18 Q. And if there is a settlement agreement, the
19 process is likely to be shorter than if the matters are
20 litigated; correct?

21 A. Yes.

22 Q. And as far as discovery issues are concerned,
23 that process, can that also be shortened?

24 A. Yes, and there are, you know, costs that can be
25 mitigated, as I explained about the amount of data

1 requests.

2 Q. And in this case did RUCO try to work with a
3 company to reduce discovery issues?

4 A. Yes, there was that memo that was discussed.
5 We're in the process of analyzing Gold Canyon and then
6 Far West here. When we were getting a pile of data
7 requests, all of a sudden we realized that maybe we don't
8 require the duplicate copy of these massive data
9 requests.

10 So we came to the conclusion that maybe we
11 should explain to them that we are going to receive these
12 large amounts of data requests, maybe we don't need the
13 second copy. I think that's when we contacted the
14 company to say that maybe we could, you know, mitigate
15 the costs here.

16 Q. And in your words, what was that company's
17 response?

18 A. I guess they weren't interested in changing the
19 status quo as it was done, sending two copies of
20 everything.

21 Q. And has this been their response in other issues
22 involving discovery matters in this case?

23 A. Mr. Bourassa and I have talked informally on
24 several of the issues, but when it comes to providing the
25 data, it always comes as a standard format.

1 Q. For instance, let me ask you about adjustments
2 that Mr. Bourassa and you have agreed on. How does that
3 process work, Mr. Moore?

4 A. In the beginning, in our initial analysis, for
5 instance, bill counts or plant schedules, if I notice,
6 you know, a discrepancy between my records and his, I
7 contact him and we, you know, more or less reach
8 agreement as to whether we're going to disagree or if
9 there is a problem in one or another of our schedules.

10 Q. And when you do reach an agreement, does the
11 company put those adjustments in place, have you found?

12 A. Well, in this application, there was verbiage to
13 where they agreed, and yet, as yesterday, Mr. Bourassa
14 states in the beginning that he agrees with adjustment
15 number 9, which is to remove the unnecessary expenses,
16 and yet I had to adjust one of those adjustments
17 yesterday. It isn't in the schedules, and there is a
18 small one in the plant schedules also.

19 Q. In general, Mr. Moore, how is working with this
20 company different than working with other companies, such
21 as APS?

22 A. In my direct testimony, when I talk about
23 Southwest Gas as a reality check -- and certainly their
24 rate-case expenses were a lot less.

25 When that rate case was delivered to us, they

1 hand-delivered it and discussed the adjustments they were
2 going to make and gave us a heads up of what they
3 wanted. At the end of the meeting, they gave us the
4 business cards of all the people that were involved in
5 it. So if we had an issue with an adjustment, we had a
6 direct line of communication with a person.

7 When we did send out a data request, we received
8 a call from the company asking us, "What is it you --
9 just let me know what you really want."

10 And we said, "Well, we want to verify the income
11 statement, the monthly income statement."

12 They said, "Well, you've asked for a general
13 ledger, but really what you need" -- and they would
14 explain to us -- "what you need is what we call a
15 GL-261."

16 And I says, "Oh, well, thank you very much."

17 They said, "If you just forward it with an
18 e-mail, we'll change your data request and we'll make
19 sure you get that information."

20 Or they would say, "Boy, you asked for the
21 miscellaneous account code. Do you realize how many
22 pages that is?" so we would reach agreement on a sample.

23 These types of things, that there was contact, I
24 would say, on a daily basis with somebody either in the
25 bill counts or the income statement. It reduced a lot of

1 confusion and a lot of further data requests for
2 clarification.

3 Q. This cooperation you're describing, is that
4 different than what you experienced with this company?

5 A. There tends to be less one-on-one communication
6 and more involvement with written data requests for
7 clarification.

8 Q. Okay. Does this, in fact, increase the
9 rate-case expense?

10 A. I would assume so, yes.

11 Q. Mr. Moore, you were asked some questions about
12 the amount that is spent on rate-case expense. Let me
13 ask you, just because a company spends a certain amount
14 on rate-case expense, that doesn't necessarily mean it's
15 reasonable, does it?

16 A. No. If they try to establish an unorthodox
17 argument or spend considerable amount on a cost of
18 capital study or different issues which are abnormal or
19 atypical to a rate case, then, you know, the rate payors
20 should not have to be burdened with that cost.

21 Q. And isn't that what the Commission said in the
22 Arizona American decision that is set out in RUCO Exhibit
23 No. 3, decision number 67093, regarding rate-case
24 expense?

25 MR. SHAPIRO: Again, I object. The decision

1 speaks for itself.

2 ALJ WOLFE: Sustained.

3 MR. POZEFSKY: I'll withdraw the question.

4 Q. (BY MR. POZEFSKY) You were asked some questions
5 yesterday by Mr. Shapiro regarding the -- what RUCO is
6 recommending with regard to charging -- the company
7 charging Mesa Del Sol for the effluent. Was that your
8 recommendation, that RUCO is recommending the company
9 start charging Mesa Del Sol for the effluent?

10 A. No. We have no issue with that contractual
11 agreement. Our position is that the rate payors should
12 be held harmless for that decision of the company to --
13 the company entered into this contractual obligation, and
14 the rate payors should benefit from the revenue that
15 is -- that would have been generated from that tariff.

16 So we're -- the revenue should be imputed to
17 allow the rate payors to receive the benefit of the value
18 of that effluent according to the tariff.

19 MR. POZEFSKY: Thank you. Nothing further.

20 ALJ WOLFE: Mr. Shapiro, do you have recross?

21 MR. SHAPIRO: I do, Your Honor.

22

23 RECROSS-EXAMINATION

24

25 Q. (BY MR. SHAPIRO) Let's start with the last

1 issue first. Foregoing revenue from effluent sales to
2 the Mesa Del Sol golf course in your view imposes a
3 burden on the rate payor? It's like an expense,
4 essentially?

5 A. Basically I have two issues: One is, it's
6 discriminatory among the classes; and secondly, there is
7 a foregone revenue that should be imputed to benefit the
8 rate payors.

9 Q. I appreciate your position, but let me ask my
10 question, and ask you to answer it. Foregoing the
11 revenue in your opinion creates a burden on the rate
12 payors. There would have been \$31,000 of revenue
13 requirement they don't need to incur; now you believe
14 they do?

15 A. Ask me once more, please.

16 Q. Let me try it this way. If we spent \$31,000 to
17 dispose of effluent, the question would be whether that
18 was a prudent amount and whether it benefited rate
19 payors; correct?

20 A. Okay. Yes.

21 Q. You agreed with me yesterday that disposing of
22 effluent was a benefit to rate payors; correct?

23 A. Okay. Yes.

24 Q. Do you have any evidence demonstrating that the
25 Water Utility Association of Arizona speaks for Far West

1 Water and Sewer Company?

2 A. No.

3 Q. Do you even know whether this utility is a
4 member of that association?

5 A. No.

6 Q. Is the Arizona Corporation Commission assessing
7 property taxes on Far West Water and Sewer in this case?

8 A. Determining a level of expense for property tax
9 with a historical test year.

10 Q. Is the answer to my question no, they're not
11 assessing property taxes?

12 A. They're not assessing property taxes.

13 Q. The Department of Revenue does that?

14 A. Right.

15 Q. The document R-11 that Mr. Pozefsky asked you
16 about, can you look at the number 6 in the first
17 paragraph?

18 A. Yes.

19 Q. It says produce a minimum tax impact from the
20 previous year; correct?

21 A. Yes.

22 Q. Does that sound like a forward-looking formula,
23 Mr. Moore?

24 A. I don't know.

25 Q. Every pro forma adjustment creates a mismatch

1 between test year rate-based revenue and expenses;
2 correct?

3 A. No. That creates the match between -- when you
4 annualize customer-based and then you annualize the
5 expenses, it matches.

6 Q. If we had a known and measurable increase in
7 purchased power for a power company outside the test
8 year, we would make that adjustment because it's known
9 and measurable; correct?

10 A. For the amount of power that was required to
11 provide service to the test-year customers, yes.

12 Q. But it's a different number than the number that
13 was in the test year?

14 A. Yes.

15 Q. Mr. Rigsby's hypothetical capital structure
16 doesn't match rate base in this case, does it?

17 A. I'm sorry, you'd have to talk to him.

18 Q. RUCO asked Far West Water and Sewer to provide
19 it with copies of all data requests provided to staff in
20 this case; correct?

21 A. In the -- yes, in the face sheet, yes.

22 Q. And you asked for two copies of everything that
23 was provided to staff; correct?

24 A. In writing.

25 Q. RUCO never withdrew that data request, did it?

1 A. The face sheet on the data request has not been
2 justified, but the memo to you was like -- more or less
3 like an olive branch to start mitigating some of the
4 costs, yes.

5 Q. Mitigating the costs by the company contacting
6 RUCO when the company felt that the size of the data
7 request response was too big for RUCO?

8 Let me withdraw that question and try it this
9 way.

10 RUCO asked the company to make a determination
11 based on the volume of the data request whether to
12 contact RUCO to see if RUCO wanted it. Isn't that true?

13 A. Yes, and when, you know, the original copies are
14 a foot high and you send the girl over to make 13 copies
15 of it, you think, well, you know, I should check to see
16 whether or not RUCO really needs two copies of this
17 before it is dumped on our desk.

18 Q. So you want us to check and see whether we
19 really should respond to RUCO's specific written data
20 request? That's what you're asking for, isn't it,
21 Mr. Moore?

22 A. It's just an opportunity to reduce costs. I
23 mean, all of a sudden you have a request to provide a
24 large amount of data, and you have to give it to all the
25 intervenors, you say, is this important in my analysis,

1 and --

2 Q. Mr. Moore, how do I know what's important in
3 your analysis? Isn't that RUCO's responsibility?

4 A. But I don't know what the data request is
5 because it comes from another party.

6 Q. Well, and isn't that why I offered in responding
7 to Mr. Pozefsky's olive branch to take a copy of the data
8 request that was sent to staff, put it in a room, and
9 invite a RUCO staff person to come down, review it,
10 identify specifically what it wanted copies of? Isn't
11 that what the company offered to do?

12 A. We don't receive a copy of staff's data requests
13 ahead of time.

14 Q. I understand that, Mr. Moore. Let me explain.
15 Maybe I misled you.

16 Wasn't the response to Mr. Pozefsky's request
17 that we would be happy, before sending a copy of a
18 response to a staff data request, to take that response,
19 put it into a room, invite you or somebody else from RUCO
20 down to look through that stack and identify specifically
21 what RUCO wanted from the stack? Isn't that what we
22 offered?

23 A. Subject to check, yes.

24 Q. Would you like to look at the response?

25 A. No.

1 Q. So that is what we offered to the best of your
2 knowledge?

3 A. Yes.

4 Q. Did RUCO respond or take the company up on that
5 offer?

6 A. That just makes it more frustrating than just,
7 you know, do you need this?

8 Q. Mr. Moore, let me ask you this. If RUCO would
9 have followed the process that we suggested, then it
10 would have been RUCO deciding what out of the response to
11 the staff data request RUCO deemed important; correct?

12 A. It's the duplicate copy. We'll receive a copy
13 of everything, and the process being the process, small
14 amounts of responses, send both copies. But when you're
15 going to send out a data request, and that amounts to a
16 huge amount of data, just maybe we don't need that second
17 copy.

18 Q. So in the next rate case Mr. Pozefsky could
19 write a letter that said if the response is larger than
20 three inches, please contact me, or please only send one
21 copy? He could do that, couldn't he?

22 A. We could look into it, yeah.

23 Q. In this case the company was asked to provide
24 two copies to RUCO of everything it sent to staff;
25 correct?

1 A. Yes.

2 Q. And in this case the company did that; correct?

3 A. Oh, to the letter.

4 Q. Thank you.

5 You had a number of discussions with
6 Mr. Bourassa regarding accounting issues in this case
7 informally; correct?

8 A. We have talked several times.

9 Q. Mr. Bourassa ever refuse to speak to you about
10 an issue?

11 A. No.

12 Q. When Mr. Bourassa takes time to discuss an issue
13 with you, that hopefully prevents it from becoming
14 something more complicated that increases rate-case
15 expense?

16 A. Yes.

17 Q. But you expect when he's talking to you he's
18 charging his client for his time; right?

19 A. Yes.

20 Q. Isn't that what Mr. Bourassa does? He sells his
21 time; correct?

22 A. Correct.

23 Q. It's what lawyers do too; right?

24 A. I think so.

25 Q. Hopefully they sell the time they spend.

1 Now, the folks you met with from Southwest
2 Gas -- Southwest Gas is a very large utility company
3 compared to Far West, isn't it?

4 A. Quite large, yes.

5 Q. And the people that met with you, were these
6 in-house people or were they hired consultants?

7 A. I believe they were all in-house.

8 Q. So the cost of having those people undertake
9 that process is being borne by the rate payors through
10 operating expense?

11 A. As compared to being placed in the rate-case
12 expense account?

13 Q. Yes.

14 A. Some of it.

15 Q. You're not suggesting that this Commission
16 should reduce Far West's requested rate-case expense by
17 \$90,000 to punish the company for not meeting with RUCO
18 to exchange business cards and discuss adjustments, are
19 you?

20 A. My point is that when the company says the
21 process is the process, there are variations in the
22 process, and some of them can mitigate costs.

23 Q. But it is an adversarial process, isn't it,
24 Mr. Moore? We're here litigating, aren't we?

25 A. It's not a personal thing.

1 Q. Mr. Moore, I didn't say it was personal. I said
2 it was adversarial. It's a business, but we are
3 adversaries in this case?

4 A. We have difference of opinion.

5 Q. And every dollar you take away is a dollar my
6 client would like to recover; correct?

7 A. Yes.

8 Q. And you would agree with me that in order for
9 the process to be less adversarial, that will take the
10 cooperation of all parties, not just the utility company;
11 correct?

12 A. The initiation of exploratory settlement
13 agreements may be advantageous to the company.

14 Q. May be advantageous to the Commission, to the
15 rate payors, to staff and RUCO too; right?

16 A. Well, the rate payors, yes.

17 MR. SHAPIRO: Thank you, Mr. Moore.

18 ALJ WOLFE: Anything further?

19 MR. POZEFSKY: Nothing further, Your Honor.

20 Thank you.

21 ALJ WOLFE: Thank you for your testimony. I
22 appreciate it, Mr. Moore. You're excused as a witness.

23 THE WITNESS: Thank you very much.

24 MR. POZEFSKY: Your Honor, I suppose I should
25 move for the admission of RUCO Exhibit No. 11.

1 ALJ WOLFE: Is there any objection?

2 MR. SHAPIRO: No.

3 ALJ WOLFE: R-11 is admitted.

4 (Exhibit R-11 was admitted into evidence.)

5 ALJ WOLFE: I also failed to admit A-7, which is
6 a late-filed exhibit that the company is providing. So
7 at this time I'm going to admit A-7.

8 (Exhibit A-7 was admitted into evidence.)

9 MR. SHAPIRO: Thank you, Mr. Moore.

10 ALJ WOLFE: Mr. Pozefsky, are you ready to call
11 your next witness?

12 MR. POZEFSKY: I am. At this time RUCO would
13 call Mr. William Rigsby.

14

15 WILLIAM RIGSBY,

16 A witness called on behalf of RUCO, having first been
17 duly sworn by the Court Reporter to speak the truth and
18 nothing but the truth, was examined and testified as
19 follows:

20

21 DIRECT EXAMINATION

22

23 Q. (BY MR. POZEFSKY) Good morning, Mr. Rigsby.

24 A. Good morning.

25 Q. Please state your name for the record.

1 A. My name is William Rigsby.

2 Q. What's your current occupation and by whom are
3 you employed?

4 A. I am a public utilities analyst 5. I'm employed
5 by the Residential Utility Consumer Office. Our address
6 is 1110 West Washington, Suite 220, Phoenix, Arizona,
7 85007.

8 Q. Mr. Rigsby, did you prepare testimony in this
9 matter?

10 A. Yes, I did.

11 Q. You should have before you what's marked RUCO's
12 Exhibit No. 5, RUCO's Exhibit No. 6, and RUCO's Exhibit
13 No. 7. Do you see that?

14 MR. SHAPIRO: Wasn't R-5 Mr. Rigsby's
15 surrebuttal?

16 MR. POZEFSKY: Right. I corrected that. R-6
17 and R-7.

18 MR. SHAPIRO: Thank you.

19 THE WITNESS: Yes, I have those here.

20 Q. (BY MR. POZEFSKY) Mr. Rigsby, is that your
21 direct testimony, RUCO-6, and your surrebuttal testimony,
22 RUCO-7?

23 A. Yes.

24 Q. Was that prepared by you, Mr. Rigsby?

25 A. Yes.

1 Q. At this time do you have any corrections or
2 additions to make to that?

3 A. No.

4 Q. Mr. Rigsby, in response to your rejoinder
5 testimony, do you have any response to your rejoinder
6 testimony at this time?

7 A. The only thing I'd like to point out is I would
8 like to take exception to two of the items that I believe
9 Mr. Bourassa referred to or pointed out in his
10 testimony. One is his description of my using an
11 incorrect geometric mean in the CAPM analysis. Use of
12 the geometric mean in my opinion is not incorrect, just
13 simply one more way of arriving at an average.

14 The other thing I would like to take exception
15 to is I think he made some comments here on the stand the
16 other day. I believe, if my memory serves me correctly,
17 he was referred to the CAPM or talking about the CAPM as
18 being an unstable model, and I just would like to take
19 exception to that because I don't believe the CAPM is an
20 unstable model. I think CAPM does what CAPM is designed
21 to do.

22 That pretty much sums it up.

23 Q. And what is CAPM designed to do, Mr. Rigsby?

24 A. The capital asset pricing model is a stock
25 valuation model that was developed actually by two

1 analysts in the early 1960s. One was a gentleman by the
2 name of William Sharpe. He was the principal developer
3 of the model. He did it in collaboration with another
4 gentleman named Harry Markowitz. Both of those gentlemen
5 received the Nobel Prize in economics for that work in
6 1990.

7 Q. Is there anything else you'd like to say in
8 response to the rejoinder testimony, Mr. Rigsby?

9 A. No, not at this time.

10 MR. POZEFSKY: Your Honor, at this time I would
11 move for the admission of RUCO Exhibit No. 6 and RUCO
12 Exhibit No. 7.

13 ALJ WOLFE: There having been no objection made,
14 R-6 and R-7 are admitted.

15 (Exhibits R-6 and R-7 were admitted into
16 evidence.)

17 MR. POZEFSKY: I would tender Mr. Rigsby for
18 cross-examination.

19 ALJ WOLFE: Thank you.

20 Mr. Layton, does staff have any questions for
21 this witness?

22 MR. LAYTON: No, I don't, Your Honor.

23 ALJ WOLFE: Mr. Shapiro?

24 / /

25

1 CROSS-EXAMINATION

2

3 Q. (BY MR. SHAPIRO) Good morning, Mr. Rigsby.

4 A. Good morning, Mr. Shapiro.

5 Q. Let me pick up on a couple of things you said on
6 direct.7 Didn't Mr. Bourassa actually testify that he
8 believes staff's current risk premium CAPM was unstable?9 A. I haven't seen the transcripts yet, but I take
10 your word for that, subject to check. At the time I
11 believe he was talking specifically about the CAPM model,
12 but if he wasn't --13 Q. He has expressed concern with other parties' use
14 of the CAPM model. He hasn't challenged the
15 Nobel-Prize-winning economists' adoption of this model,
16 has he?17 A. No, but he's also criticized my use of the model
18 too.

19 Q. Right. I said staff and RUCO.

20 A. Yes.

21 Q. And you would agree with me this model was
22 created some 45 years ago, correct, and we're still using
23 the same version of it created in 1960?24 A. Well, most of the models that we use were
25 developed around the same time frame.

1 Q. The world's economy has changed in 45 years
2 somewhat, hasn't it?

3 A. Technologically-wise -- technology-wise,
4 perhaps, but I don't think that -- I don't think it's
5 changed to the point where it has devalued the value of
6 the models.

7 Q. It's not your or RUCO's position that any of the
8 cost-of-capital witnesses in this case are not qualified
9 to present cost-of-capital testimony, is it?

10 A. No.

11 Q. The methodology that you used in the same case,
12 that's the same methodology that you generally use in
13 every rate case?

14 A. That's correct.

15 Q. The same that you used in the recent and
16 still-pending Black Mountain Sewer case?

17 A. That's correct.

18 Q. I cross-examined you on cost of capital in that
19 case last month; correct?

20 A. That's correct.

21 Q. Far West Sewer Company would compare to the --
22 in fact, you used the same sample companies in that case
23 as you did in this case; correct?

24 A. Yes.

25 Q. Far West would compare to those same sample

1 companies the same way Black Mountain would; correct?

2 A. Yes.

3 Q. They're all utilities and they're all regulated;
4 correct?

5 A. Correct.

6 Q. That's really all you need to know to do your
7 cost-of-capital analysis about the specific company?

8 A. Well, yeah. The idea is to try to come up with
9 a proxy that, you know, is engaged in similar work and
10 faces similar roles as the company we're trying to
11 determine cost of equity on.

12 Q. There is no debt financing any plant being used
13 during the test year by Far West to serve its sewer
14 customers, is there?

15 A. That's correct.

16 Q. You chose a hypothetical capital structure
17 because you felt that the company's actual capital
18 structure was not reflective of the capital structures in
19 the sample companies you used in your analysis? I'm
20 referring to your direct testimony.

21 A. That's correct. The companies that I used in my
22 proxy have capital structures that are comprised of
23 approximately 50 percent debt, 50 percent equity.

24 Q. So you changed Far West's capital structure in
25 this case to more closely relate to your proxy companies?

1 A. That was one reason for recommending the
2 hypothetical capital structure.

3 Q. Okay.

4 A. The other reason is that since we derived our
5 cost of equity from a proxy group that had a 50-50
6 capital structure of debt and equity, that it would not
7 be appropriate to apply that cost of equity figure to 100
8 percent common equity capital structure.

9 What I was trying to do was to arrive at a
10 weighted average cost of capital, okay, that was more in
11 line with the companies that were in my sample.

12 Basically what we have here is a situation
13 where -- and this happened in the Paradise Valley case,
14 for example -- where you have -- let's say a company
15 comes in, and they're much more leveraged. They have
16 debt in their capital structure. And so they make the
17 argument that because their capital structure is more
18 leveraged, there should be an upward adjustment to the
19 cost of common equity for the financial risk that exists,
20 the increased financial risk as a result of the leveraged
21 capital structure.

22 THE WITNESS: Okay, in those cases we have in
23 the past recommended a 50-basis-point upward adjustment
24 to the cost of common equity. Staff and I both
25 recommended a 50-basis-point upward adjustment in the

1 last Arizona American rate case. We recommended
2 something -- I believe staff was at 60 basis points, I
3 was at 50 basis points in the PV case. And there is a
4 rule on that now.

5 Basically what we did was we took into account
6 they had more debt in their capital structure than
7 equity, so we made an upward adjustment. What my
8 hypothetical capital structure is intended to do is to
9 achieve the same thing, only it brings the overall
10 weighted average cost of capital down to reflect the fact
11 that Far West's capital structure is comprised of 100
12 percent equity. Therefore, it doesn't require as high a
13 cost of common equity.

14 Q. Mr. Rigsby, you didn't look at any of the
15 company's -- what I guess are called firm-specific
16 factors; correct?

17 A. Are we talking about Far West?

18 Q. Yes.

19 A. I did a market-based analysis on companies that
20 I believe have similar risk characteristics as Far West.

21 Q. Mr. Rigsby, that wasn't my question. Did you
22 look at any of this utility's specific risks or specific
23 business characteristics in your analysis?

24 A. I looked at the company's application, and I
25 came to the conclusion that this company is not that much

1 more different than any other wastewater -- regulated
2 wastewater facility that operates in the Arizona
3 jurisdiction.

4 Q. So you just treat every wastewater utility
5 essentially as the same?

6 MR. POZEFSKY: Your Honor, I object. I think
7 that mischaracterizes his testimony.

8 MR. SHAPIRO: I'll let his prior answer stand
9 and withdraw the question. I think it was pretty clear.

10 Q. (BY MR. SHAPIRO) You didn't even use Far West's
11 capital structure in this case, did you?

12 A. I just explained why I didn't.

13 Q. So you would agree with me that excluded from
14 your analysis on cost of capital is every specific fact
15 regarding the utility whose cost of capital you're
16 setting?

17 A. I wouldn't say that.

18 Q. Well, tell me what you considered in your
19 analysis that is specific to Far West.

20 A. Again, I looked at the company's application.

21 Q. How did the company's application affect your
22 cost-of-capital analysis?

23 A. Based on my review of it, I saw nothing about
24 Far West that made it that much more different from many
25 of the other wastewater companies that operate here in

1 Arizona. They have similar problems. They face similar
2 risks. They operate in the same jurisdiction. They're
3 a -- in this case, they've developed their own, like a
4 number of other wastewater facilities.

5 Q. You looked at the application and concluded that
6 Far West was like every other utility in Arizona that
7 provides sewer service. Is that fair?

8 A. That's fair.

9 Q. Did you look at the application of Black
10 Mountain and determine Black Mountain was like every
11 other sewer company in Arizona?

12 A. In the case of Black Mountain, there is a
13 difference in the ownership structure. But again, they
14 operate in the same jurisdiction. They provide the same
15 type of service. They face the same type of regulatory
16 mandates.

17 Q. Well, if every regulatory utility -- if every
18 regulated sewer utility essentially operates in the same
19 jurisdiction and faces the same risk, why do we do a
20 cost-of-capital analysis in each case? Why not just set
21 a yearly cost of capital for water companies and let them
22 all collect that in their rates?

23 A. I don't think that would be fair to the
24 companies, tell you the truth, the economic environment
25 changes, and just because we're recommending one cost of

1 equity in this case, that doesn't mean we'd recommend the
2 same thing two, three years down the road.

3 Q. You testified that the sample companies have
4 greater risk than Far West Sewer Company.

5 A. Can you clarify that, when you say "greater
6 risk"?

7 Q. Yeah, that's because in your belief they have
8 more debt in their capital structure; correct?

9 A. Because they have more debt in their capital
10 structure, they face more financial risk.

11 A company doesn't have any debt in its capital
12 structure, has no debt, there is no financial risk.
13 There is no risk of default on debt instruments.

14 Q. You're aware the company was recently fined by
15 the State of Arizona over \$1.7 million?

16 A. Are we talking about the -- are we talking about
17 the accident involving the employees?

18 Q. I'm talking about the fine, yes.

19 A. I was aware of it. Yes.

20 Q. And you're aware the company faces a number of
21 ADEQ compliance violations?

22 A. Yes.

23 Q. You're aware the company is looking at a price
24 tag of \$14 million to upgrade its sewer facilities and
25 another 7 or 8 million for an additional water plant?

1 A. Yes.

2 Q. This is a closely held company?

3 A. That is true too.

4 Q. And just to be clear, it's your testimony that
5 an investment in Aqua American or American States is more
6 risky than an investment in Far West Sewer? That's your
7 position, isn't it?

8 A. What I'm saying is, I've selected sample
9 companies that face similar risks. They probably have
10 the same types of problems that Far West faces. They
11 have to face regulatory agencies. They have to comply
12 with environmental requirements and so forth.

13 Q. If I invest in a utility that owns one system
14 and there is a big problem, versus investing in a utility
15 that owns 50 systems and there is a big problem, in which
16 case is my investment more likely to be at risk?

17 A. I can't say that because who is to say? If an
18 investor does some due diligence, looks at both
19 companies, if he feels more comfortable with management
20 of the smaller company, he may go with that.

21 Q. Your recommendation is 9.04 in this case;
22 correct?

23 A. Yes.

24 Q. In your direct you recommended return on equity
25 of 9.56 percent?

1 A. That's correct.

2 Q. In time period of time between your direct and
3 your surrebuttal, interest rates have increased; correct?

4 A. Interest rates have increased, but there have
5 been changes in the stock prices, that we used a DCF
6 model.

7 Also, I believe during that time, as I'm looking
8 at the dates here -- you have to remember, my direct
9 testimony was filed on April 11. At that time I was
10 relying on Value Line data that was published in January
11 of this year.

12 After we filed our direct testimony on April 28,
13 Value Line Investment Survey came out with their next
14 quarterly update.

15 So I was able to revise those numbers, and when
16 I reran my analysis, I came up with a lower failure, and
17 that's what I recommended in my surrebuttal testimony.

18 Q. What is the current prime interest rate,
19 Mr. Rigsby? You can refer to RUCO R-9 if you like.

20 A. I believe the fed funds rate is at 5 and a
21 quarter right now, and prime generally moves in
22 300-basis-point locksteps. I believe it's 8.25 if memory
23 serves me correctly.

24 Q. You would agree with me approximately a year ago
25 it was 200 basis points lower?

1 A. That's correct.

2 Q. You testified in the Arizona Water Eastern Group
3 rate case approximately three years ago; correct?

4 A. I believe so, yes.

5 Q. Weren't interest rates at historical lows around
6 that time?

7 A. They were at historical lows then. They're
8 still really at historical lows, even though the Federal
9 Reserve has ratcheted up the federal fund rate 17 times
10 over the last couple of years.

11 One of my schedules actually has about -- I
12 think it goes back to 1990. When you compare those rates
13 in 1990 versus now, they're still pretty low. They're
14 still regarded as low by historical standards.

15 Q. Well, in this range of lows, you would agree
16 with me that the historical lows we saw approximately
17 three years ago were 300 to 400 basis points lower than
18 the historical lows we're seeing today?

19 A. Subject to check, yes.

20 Q. Subject to check, would you agree with me that
21 in decision 66489, the Eastern Group decision, you
22 recommended a cost of equity equal to 9.18 percent?

23 A. Yes.

24 Q. You would agree with me that that is 14 basis
25 points higher than your recommendation in this case?

1 Just a math question.

2 A. Well, I think what you have to understand,
3 Mr. Shapiro, is that you're looking at interest rates in
4 a vacuum.

5 Q. Mr. Rigsby, I'm just looking at your final
6 number.

7 A. No, I don't deny the fact that's what I may have
8 recommended at that particular point in time, but again,
9 interest rates alone, that's not the sole input, the sole
10 component on which I base my recommendations on.

11 Q. I understand that.

12 You would agree with me that the cost of equity
13 under the CAPM model moves the same direction as interest
14 rates, doesn't it?

15 A. Yes. Well, it would -- there are several
16 components to it. That's one of them.

17 Q. But generally the cost of equity moves in the
18 same direction as interest rates?

19 A. If you hold all the elements of the model
20 constant and you simply plug in interest rates, it will
21 move up or down depending on what the interest is.

22 Excuse me, again, that's assuming also that
23 you're holding the return on a market constant also. I
24 think if you recall back when we were here in this
25 hearing room for the Black Mountain Sewer case, I think

1 you fellows wanted me to simply plug in a current T-bill
2 rate, and at the time I couldn't just plug that number in
3 because I knew there had been changes. I knew that the
4 beta -- the average beta coefficient had dropped
5 slightly, and so had the overall return on the market.

6 But if you hold those other elements of the
7 model constant and if you just plug in an interest rate,
8 yes, the model will move up or down depending on whatever
9 the interest rate is.

10 Q. Mr. Rigsby, if I don't ask you any more
11 questions, we'll save rate-case expense; correct?

12 A. Rate-case expense?

13 MR. SHAPIRO: I'll withdraw the question.

14 THE WITNESS: I didn't testify on that.

15 MR. SHAPIRO: That's all we have. Thank you.

16 THE WITNESS: Sure.

17 ALJ WOLFE: Redirect?

18 MR. POZEFSKY: Just a few questions.

19

20 REDIRECT EXAMINATION

21

22 Q. (BY MR. POZEFSKY) Mr. Rigsby, the issue of
23 company-specific data, in your analysis did you look at
24 the company's ability to access capital?

25 A. One of the things that I did do, if you look at

1 my hypothetical cost of debt, the way I arrived at that
2 number was I looked at the cost of debt for -- I believe
3 there were eight companies. I not only used the four
4 companies that I used in my proxy to determine cost of
5 equity, but I also used the companies that are used in
6 the mid-cap -- small, mid-cap edition that Value Line
7 puts out.

8 What I did, I looked at their SEC 10-K filings.
9 I looked at the debt issues. I threw out the ones that
10 had variable interest rates that we couldn't get a good
11 handle on or they just didn't state what the rates were.
12 So what I did was pretty liberal.

13 Anyway, what I did, I developed a weighted cost
14 of those debt instruments, and I came up with a 6.45
15 percent weighted cost of capital for those companies.

16 Now, when I made my final recommendation for my
17 hypothetical cost of debt for Far West Water, what I did
18 was I added an additional 200 basis points to that
19 figure. So that's how we come up with that 8.45 percent
20 cost of debt that I'm recommending for the hypothetical
21 capital structure.

22 The reason that I did that, I'm willing to
23 recognize the fact that the company may have some
24 business-specific risks and also I know for a fact that
25 if you're an investor in wastewater utilities -- it may

1 have changed; I don't believe it has -- if you're an
2 investor in wastewater utilities, I don't believe you
3 have access to WIFA funds. That's my understanding.

4 Also, the reason I did that is, as much
5 information as I try to get on these companies, it's
6 tough to find out what the terms are of all their debt
7 instruments, whether or not they were Industrial Revenue
8 Authority bonds or they are just bonds that are offered
9 by the state they operate in or specifically geared
10 towards water and wastewater-type companies and so forth.

11 So that was the other reason why I thought it
12 would be prudent to go ahead and bump up that 6.45 figure
13 to the 8.45 figure that I recommended.

14 MR. POZEFSKY: Nothing further. Thank you,
15 Mr. Rigsby.

16 ALJ WOLFE: Thank you for your testimony,
17 Mr. Rigsby. You're excused as a witness.

18 RUCO, do you have anything further, or is this
19 your entire case?

20 MR. POZEFSKY: That's our entire case, Your
21 Honor.

22 I didn't have it checked off; I wanted to make
23 sure I did include or have admitted RUCO's Exhibit No.
24 10.

25 ALJ WOLFE: It was admitted, yes.

1 MR. POZEFSKY: All of RUCO's exhibits have been
2 admitted except 3, which is judicial notice from my
3 notes.

4 ALJ WOLFE: My notes agree with that.

5 MR. POZEFSKY: Thank you. Nothing further.

6 ALJ WOLFE: Mr. Layton, staff prepared to call
7 its first witness?

8 MR. LAYTON: Is this a good time to take a short
9 break?

10 ALJ WOLFE: I was hoping to go through until
11 11:30 and take a lunch break at that time. Is your
12 witness available?

13 MR. LAYTON: No, he's available.

14 Staff calls Mr. Liu to the stand.

15 ALJ WOLFE: If you need a break, we can take
16 one. Don't want to be hard-nosed.

17 MR. LAYTON: Then I will request one. There is
18 something I want to confer with staff on for this
19 witness.

20 ALJ WOLFE: Is five minutes enough? Ten
21 minutes? Okay, we'll be back here at 11, 11:05.

22 (Recess at 10:50 a.m.; resumed at 11:07 a.m.)

23 MR. SHAPIRO: We found a mathematical --

24 ALJ WOLFE: Let's go on the record.

25 Mr. Shapiro?

1 MR. SHAPIRO: We found a mathematical error in
2 Mr. Bourassa's rebuttal testimony. I could certainly put
3 him on the stand if you like. I think it's
4 self-explanatory. It's on page 8 at line 22 where
5 Mr. Bourassa breaks down the 147,525 in dispute with
6 staff.

7 MR. LAYTON: Mr. Shapiro, is that rejoinder
8 testimony?

9 MR. SHAPIRO: No, it's his rebuttal at page 8.
10 On line 22 he has overhead cost of 110 and profit of
11 47,525, which adds up to 157,525, not 147,525. So the
12 47,525 should be 37,525. That's the mathematical error.

13 We're happy to have him on the stand if need
14 be. Otherwise I would ask the record reflect the
15 correction of page 8, line 23, and the 4.75 percent
16 should be 3.75 percent.

17 ALJ WOLFE: Do either of the parties need
18 Mr. Bourassa to get on the stand to make that correction?

19 MR. POZEFSKY: No, Your Honor.

20 MR. LAYTON: No, Your Honor.

21 ALJ WOLFE: Okay. The record will reflect the
22 correction to page 8, line 23 of Exhibit A-5.

23 MR. SHAPIRO: Thank you.

24 MR. LAYTON: Staff will be entering some
25 exhibits that supported its position regarding that

1 number. They may not reflect Mr. Bourassa's updated
2 numbers. But we can probably, with our brief, when we do
3 our final schedules, make any update we need to based on
4 that.

5 ALJ WOLFE: That's one of the purposes of the
6 final schedule filing. So that would be fine. I
7 appreciate that.

8 Mr. Layton, you did call Mr. Jian Liu, I
9 believe.

10 If you'd step up to appear, Mr. Liu, you'll be
11 sworn in by the court reporter.

12

13 JIAN LIU,
14 A witness called on behalf of Staff, having first been
15 duly sworn by the Court Reporter to speak the truth and
16 nothing but the truth, was examined and testified as
17 follows:

18

19 DIRECT EXAMINATION

20

21 Q. (MR. LAYTON) Good morning, Mr. Liu. Could you
22 state your name and business address for the record?

23 A. My name is Jian Liu. My business address is
24 1200 West Washington Street, Phoenix, Arizona, 85007.

25 Q. By whom and in what position are you employed,

1 Mr. Liu?

2 A. I'm a water and wastewater engineer for Arizona
3 Corporation Commission, the utilities division.

4 Q. Could you briefly describe your duties in that
5 position?

6 A. As a water/wastewater engineer, my
7 responsibilities include dispatching investigation in the
8 examination of water/wastewater systems, providing
9 technical recommendations, and suggesting corrective
10 action of water and wastewater systems, providing written
11 and oral testimony on rate applications and on cases
12 before the Commission.

13 Q. In the course of your employment, did you review
14 and evaluate a request for a rate increase from Far West
15 Water and Sewer?

16 A. Yes.

17 Q. Did you prepare and prefile any testimony in
18 this case?

19 A. Yes.

20 Q. And do you have before you staff exhibit
21 previously marked as S-19?

22 A. Yes.

23 Q. Could you please identify this exhibit for the
24 record?

25 A. It's direct testimony prepared by me.

1 Q. So it was prepared by you or under your
2 direction?

3 A. Yes.

4 Q. Could you turn to page 3 of your testimony?

5 A. Yes.

6 MR. SHAPIRO: Mr. Layton, what exhibit number is
7 the direct testimony?

8 MR. LAYTON: S-19, Mr. Shapiro.

9 MR. SHAPIRO: Appreciate that.

10 MR. LAYTON: Excuse me. I --

11 Q. (MR. LAYTON) At lines 9 and 10, Mr. Liu, you
12 state that the recommendations in the executive summary
13 are contained in the engineering report. Could you point
14 us to the page number in the engineering report that has
15 these recommendations?

16 A. I think it's page 9 to 10. At page 10 where it
17 recommends for -- on the recommendations, number 3.

18 Q. Mr. Liu, have you had any recent discussions
19 with ADOSH regarding the company's compliance with the
20 regulations?

21 A. Yes, I did.

22 Q. Could you tell us about those discussions?

23 A. After May 19 -- May 15 fire incident at Palm
24 Shadows wastewater treatment plant, I contacted with
25 compliance department and the consultation department of

1 ADOSH just asking them -- see if they know of the
2 incident.

3 Basically, they say I'm the first one to report
4 to them about that fire incident. So they told me this
5 incident is not reportable. Only if three or more
6 employees hospitalized will the report go to ADOSH. So
7 this incident is not reportable, and that's why they
8 don't know.

9 Q. Were you present, Mr. Liu, or did you hear
10 Mr. Kaveney's testimony about the fire at the Palm
11 Shadows building?

12 A. Yes.

13 Q. Do you think the company should review the
14 incident with ADOSH in its ongoing consultations?

15 A. Since this incident is not reportable, I think
16 it is the company's decision, see if they'll want to go
17 ahead doing the consultation with the ADOSH.

18 I understand Far West, it is under consultation
19 with ADOSH. ADOSH will have a site visit and interview
20 in August this year. So I think it is company's decision
21 if they want to do during that interview to mention this
22 fire incident to get some consultation from ADOSH.

23 Q. There will be no harm in the company raising
24 this and just doing a quick review to make sure that all
25 safety procedures were followed correctly?

1 A. Absolutely.

2 Q. Mr. Kaveney also talked about the company
3 participating in ADOSH's voluntary consultation program.

4 A. Yes.

5 Q. Have you had any discussions with ADOSH about
6 the company's participation?

7 A. Yes. It is a voluntary consulting program. In
8 fact, I spoke to company's safety official yesterday and
9 today. Basically, she told me as long as she is safety
10 official for Far West, the company will participate in
11 this consultation program managed by ADOSH.

12 Q. And based on one of those conversations, did you
13 have any changes or additions to your recommendations?

14 A. Yes, I do. My original report, the
15 recommendation number 3, they only cover Far West
16 employees. So after the fire incident and after hearing
17 the direct testimony by Mark Kaveney --

18 I hope I pronounce your name right,
19 Mr. Kaveney.

20 -- I feel we should add two more recommendations
21 regard this safety. Basically, recommendations number 4
22 and 5, I just added they cover, not just for Far West
23 employees but also for their contractors and
24 subcontractors of Far West wastewater facilities.

25 Since we had similar recommendations before for

1 the Safety in the Hills program, I feel it's helpful to
2 add those two more recommendations.

3 Q. Do you have Staff Exhibit S-21 up there?

4 A. S-1?

5 Q. S-21.

6 A. Yes, I do.

7 Q. Could you identify this for the record?

8 A. This is a testimony summary I prepared
9 yesterday. Basically, just added the two more
10 recommendations I just mentioned.

11 Q. And the original incident that started the
12 consultations, another company was involved; is that
13 correct? Was it Santec Corporation?

14 A. Could you repeat the question?

15 Q. Well, I'll rephrase it, Mr. Liu.

16 Are you aware of any other decisions that had
17 similar recommendations as your new recommendations 4 and
18 5?

19 A. I understand there was similar recommendations
20 like recommendations 4 and 5 before this Commission, yes.

21 Q. And so these recommendations are more or less
22 identical to those previous recommendations?

23 A. That's right.

24 Q. Mr. Liu, did the company provide you recently a
25 copy of an ADOSH consultation report?

1 A. Yes. I did receive a report this morning.

2 Q. And do you have a Staff Exhibit S-21 laying up
3 there?

4 A. I think is called S-20.

5 Q. I'm sorry. S-21. S-21A.

6 A. You're right. S-21A. I do have that copy.

7 Q. And could you identify this for the record?

8 A. That's from Diane Robinson, safety official
9 about OSHA information.

10 Q. And attached to that letter, is that the recent
11 consultation report from ADOSH regarding the company's
12 progress regarding its safety and compliance program?

13 A. Yes, this is a report from ADOSH consultation
14 program, yes.

15 Q. And do you have any other additions,
16 corrections, or modifications to your prefiled testimony?

17 A. No, I do not.

18 Q. Do you have Staff Exhibit S-20 up there,
19 Mr. Liu?

20 A. Yes, I do. That's order between ADEQ and Far
21 West.

22 Q. Does this consent order only address the Del Oro
23 facility?

24 A. Yes.

25 Q. And are you aware of whether the company is

1 currently negotiating a new consent order with ADEQ that
2 addresses the other six facilities?

3 A. I think that during Mr. Kaveney's testimony he
4 mentioned companies negotiated with ADEQ about honor
5 or -- wastewater facility about that consent order.

6 Q. Mr. Liu, one of your recommendations is that
7 rates should not go into effect until a company is in
8 compliance. What does the staff consider as compliance
9 related to this recommendation?

10 A. In fact, right now, all seven wastewater
11 treatment facility plants are out of compliance, so my
12 engineering report, the recommendation is a typical
13 Commission or -- a recommendation for all the systems out
14 of compliance.

15 But regarding this Far West Sewer rate
16 application, we realize that the company -- there is a
17 need for capital to bring the system in compliance. They
18 need revenue.

19 So after consult with my supervisor, basically,
20 we upgrade if the company sign consent order for all rest
21 of the wastewater facility and basically bring the system
22 in compliance in paper. I emphasize "in paper" because
23 as soon as sign the consent order, we can assume -- say,
24 are you in compliance in paper. Actually, they are not.

25 But as soon as there is signed consent order on

1 a formal time line with a consent order, we feel we can
2 recommend a rate increase effective immediately as soon
3 as we get a statement from ADEQ saying they sign the
4 consent order for all seven wastewater treatment plants
5 and they make progress, obey their time line with the
6 consent order.

7 Q. So do you recommend that the company file an
8 executed copy of that consent order in the docket for
9 this case?

10 A. Yes, I would. The company sign the consent
11 order, I would recommend the company file with the
12 Corporation Commission with docket control the consent
13 order that has been signed so the rate can be effective
14 immediately.

15 Q. When you say "effective immediately" -- so let
16 me clarify that. So the company docket an executed copy
17 of the consent order. The rates would then go into
18 effect on the first day of the month following the
19 docketing of that consent order?

20 A. Yes. I think that that is what I mean.

21 Q. And do you adopt in Exhibits S-19 and S-21 your
22 sworn testimony here today?

23 A. Yes.

24 MR. LAYTON: Your Honor, staff moves for the
25 admission of Exhibits S-19, S-20, S-21, and S-21A at this

1 time.

2 ALJ WOLFE: I have a question about this S-21.
3 The recommendations that appear in S-21 aren't the same
4 recommendations that Mr. Liu just made.

5 MR. LAYTON: Could you clarify that, Your
6 Honor? Are you talking about ADOSH or ADEQ?

7 ALJ WOLFE: Well, Exhibit S-21, there is a
8 second heading, Recommendations, and number 2 under that
9 recommendation concludes with what he's just testified
10 to. Do you intend to make a change to this?

11 MR. LAYTON: Your Honor, we could do a
12 late-filed exhibit conforming this exhibit to Mr. Liu's
13 testimony.

14 ALJ WOLFE: Or you could just have Mr. Liu
15 just -- I would just like to have it clear that -- so
16 that -- if you have written recommendations there you
17 could --

18 Q. (MR. LAYTON) Mr. Liu, could you look at that
19 Exhibit S-21?

20 A. Yes.

21 Q. Previously you testified that one of the reasons
22 why you wanted to add recommendations 4 and 5 was that
23 the recommendations originally only related to Far West
24 employees.

25 Could you look at recommendation number 3?

1 A. Yes.

2 Q. Would you like to change this recommendation to
3 be consistent with that testimony?

4 A. In the recommendations, number 3 covered Far
5 West employees. That's basically asking reporting,
6 training for the Far West employees, so the
7 recommendations 4 and 5, we expand that to the
8 contractors and subcontractors.

9 So you're suggesting we should add contractors
10 and subcontractors for number 3 too?

11 Q. Mr. Liu, let me clarify that with Judge Wolfe.

12 MR. LAYTON: Judge Wolfe, could you point out the
13 inconsistency you see again?

14 MR. SHAPIRO: Could we go off the record?

15 ALJ WOLFE: Certainly.

16 (Discussion off the record.)

17 ALJ WOLFE: Let me take one more shot.

18 Number 2 recommends when any increase in rates
19 and charges approved in this proceeding go into effect,
20 and number 2 says until the company is in compliance with
21 the Commission requirements and that the notice that
22 staff receives --

23 Now, Mr. Liu maybe just testified otherwise.

24 Let me just ask you, Mr. Liu, do you intend for
25 the rates to go into effect when the company docket

1 notification that a consent order for all its wastewater
2 systems has been signed with ADEQ?

3 THE WITNESS: That's right.

4 ALJ WOLFE: So that would be your recommendation
5 instead of the recommendation that appears in number 2 on
6 Exhibit S-21?

7 THE WITNESS: That's exactly right.

8 MR. LAYTON: Thank you, Your Honor. I guess I
9 didn't listen closely enough.

10 ALJ WOLFE: It's not a problem. Just want to
11 make sure the record is clear.

12 Is there any objection to S --

13 MR. SHAPIRO: No, Your Honor, and after
14 consultation with the company, probably short-circuit a
15 lot of this. With Mr. Liu's change in response to your
16 question to recommendation number 2, Far West will accept
17 and agree to all the recommendations made in S-21.

18 ALJ WOLFE: Okay. All right. So there is no
19 objection to S-21 being admitted?

20 MR. SHAPIRO: Or any of the other exhibits.

21 Will there be a late-filed version, or we'll
22 just take it from the record?

23 ALJ WOLFE: It will just be taken from the
24 record.

25 So S-19, S-20, S-21, and S-21A are admitted.

1 (Exhibits S-19, S-20, S-21, and S-21A were
2 admitted into evidence.)

3 MR. LAYTON: Mr. Liu is now available for
4 cross-examination.

5 ALJ WOLFE: Thank you.

6 Mr. Pozefsky?

7 MR. POZEFSKY: No objection, Your Honor.

8 ALJ WOLFE: Mr. Shapiro?

9 MR. SHAPIRO: Just a couple of quick questions.

10

11

CROSS-EXAMINATION

12

13 Q. (BY MR. SHAPIRO) Good morning, sir.

14 A. Good morning.

15 Q. Mr. Kaveney, when he -- now I'll do it.

16 Mr. Kaveney, when he testified, said he did not believe
17 the fire incident needed to be reported to ADOSH; is that
18 correct?

19 A. That's right.

20 Q. When you called ADOSH, they confirmed that there
21 was not a requirement to report the incident; correct?

22 A. Yes, that's right.

23 Q. You only filed direct testimony in this case;
24 correct?

25 A. Yes.

1 Q. Can I take it by that that you didn't find any
2 areas of disagreement with the prefiled rebuttal
3 testimony of Mr. Kaveney or Ms. Capestro?

4 A. Maybe there is some minor issues, but I do not
5 think that that is big enough for me to raise any kind of
6 a direct objection. Maybe some language or some minor
7 issues. We had discussion of that. I determine, say
8 that's not a major issue. So just not file any
9 objection.

10 Q. And you're also familiar with the testimony both
11 prefiled and here at the hearing of Mr. Gary Lee?

12 A. Yes.

13 Q. Is the same thing true, no material dispute
14 between staff engineering and Mr. Lee's testimony?

15 A. No. There is no major disagreement about that.

16 Q. And you did conduct an on-site inspection of the
17 facilities?

18 A. Yes, I did.

19 Q. And the company assisted you and facilitated you
20 in that effort?

21 A. Yes.

22 MR. SHAPIRO: Thank you. That's all I have.

23 ALJ WOLFE: Is there any redirect?

24 MR. LAYTON: No, Your Honor. Thank you.

25 ALJ WOLFE: Thank you for your testimony,

1 Mr. Liu. You're excused as a witness.

2 And I guess we can go ahead and take our lunch
3 break and come back at 12:40.

4 (Recess at 11:32 a.m.; resumed at 12:41 p.m.)

5 ALJ WOLFE: Let's go back on the record.

6 Mr. Layton, would you like to call your next
7 witness?

8 MR. LAYTON: Yes, thank you, Your Honor. Staff
9 calls Mr. Steve Irvine to the stand.

10

11 STEVEN IRVINE,

12 A witness called on behalf of Staff, having first been
13 duly sworn by the Court Reporter to speak the truth and
14 nothing but the truth, was examined and testified as
15 follows:

16

17 DIRECT EXAMINATION

18

19 Q. (BY MR. LAYTON) Good afternoon, Mr. Irvine.

20 A. Good afternoon.

21 Q. Would you please state your name and business
22 address for the record?

23 A. My name is Steven Irvine. My business address
24 is 1200 West Washington, Phoenix, Arizona, 85007.

25 Q. By whom and in what position are you employed?

1 A. I'm employed by the Arizona Corporation
2 Commission as a public utility analyst.

3 Q. Could you briefly describe your duties in that
4 position?

5 A. I analyze financings. I work in rate design and
6 cost of capital.

7 Q. In the course of your employment, did you review
8 and evaluate a request for a rate increase from Far West
9 Water and Sewer?

10 A. I did.

11 Q. Did you prepare and prefile any testimony in
12 this case?

13 A. I did.

14 Q. Do you have before you staff exhibits previously
15 marked as S-18 and S-18A?

16 A. I do.

17 Q. And can you please identify these exhibits for
18 the record?

19 A. S-18 is a copy of my direct testimony.

20 S-18A is a copy of surrebuttal testimony.

21 Q. Were S-18 and S-18A prepared by you or under
22 your direction?

23 A. They were.

24 Q. Mr. Irvine, are you recommending a retroactive
25 financing approval for debt related to H & S Developers?

1 A. Yes.

2 Q. Why did staff recommend retroactive approvals
3 for the financing?

4 A. To recognize substance over form. The debt
5 exists, and it brings the company into compliance with
6 requirements to obtain authorization for debt.

7 Q. In your prefiled testimony, Mr. Irvine, did you
8 identify an amount and an interest rate for that
9 retroactive approval?

10 A. I did, but that number has changed based on
11 information provided by the company since that time.

12 Q. Do you have Staff Exhibit No. S-24 up there?

13 A. I do.

14 Q. And could you identify this exhibit for the
15 record?

16 A. This is information supplied to staff by the
17 company in response to data request SI-11.1. It provides
18 information relating to account number 234.

19 Q. And does this schedule reflect the amount that
20 you're recommending for retroactive approval?

21 A. It does. On page 16 of 16, there is a data
22 cited at the bottom of the page. It is a figure which is
23 greater than or equal to four months old. The number is
24 \$571,244, and that's the amount we're recommending for
25 approval.

1 Q. And so the amount that you're recommending, it's
2 based on this accounts payable aging schedule provided by
3 the company?

4 A. It is.

5 Q. Mr. Irvine, do you have Staff Exhibit No. 26 up
6 there?

7 A. I do.

8 Q. Could you identify this for the record?

9 MR. SHAPIRO: Your Honor, I'm sorry, if I could
10 interrupt, is Mr. Irvine updating his testimony or
11 changing his testimony? This seems like a very
12 substantive series of documents. We seem to be getting
13 very late and untimely notice of the use of these
14 documents and the alteration of his testimony.

15 ALJ WOLFE: You didn't object to Mr. Liu's late
16 testimony. If we want to have not any changes to
17 testimony on the stand, we could make that, but --

18 MR. LAYTON: If I might respond, Your Honor.

19 ALJ WOLFE: Yes, please.

20 MR. LAYTON: Mr. Shapiro, Mr. Irvine, in his
21 prefiled testimony, you know that he included the debt
22 from H & S Developers and its capital structure. He has
23 recommended retroactive approval, but we just want to
24 clarify his testimony to include specifics that go to
25 that recommendation.

1 And we do realize that we're providing it late,
2 but, again, you're free in your cross-examination or in
3 your briefing to dispute the amount or the way he
4 calculated the interest rate. However you want to do it,
5 Mr. Shapiro.

6 MR. SHAPIRO: I guess for the record I would
7 clarify, while I agree Mr. Liu changed his testimony,
8 those changes were, with your assistance, quite easy to
9 follow. These are substantive financial matters for
10 which we've gotten substantive documents with a lot of
11 information. I'll need some latitude and work with
12 Mr. Bourassa as we cross-examine Mr. Irvine today.

13 MR. LAYTON: I appreciate that, Mr. Shapiro.

14 And, Your Honor, none of the data in this
15 schedule or in the other exhibit are unknown to the
16 company. The company provided this information to
17 Mr. Irvine during discovery.

18 ALJ WOLFE: And also I would add to what I -- to
19 my comment about there being late testimony is that, of
20 course, Mr. Shapiro, you can always call a rebuttal
21 witness. You always have the opportunity to do that and
22 put on testimony.

23 MR. SHAPIRO: Thank you.

24 ALJ WOLFE: We can go ahead.

25 This hasn't been moved for admission yet.

1 MR. LAYTON: Your Honor, I had a few questions
2 to Mr. Irvine to explain this exhibit.

3 Q. (MR. LAYTON) Again, Mr. Irvine, could you
4 identify this record -- this Exhibit S-26 for the record,
5 describe what it is?

6 A. I'm sorry, that was S-26; is that correct?

7 Q. Yes, sir.

8 A. Okay. S-26 is calculations I made to determine
9 annual interest rate paid on amounts in account 234.

10 Q. And the interest rate related to that account
11 is -- you use that to calculate this number at the
12 bottom, this annual interest rate of 5.93 percent?

13 A. The 5.93 percent that you see there is
14 calculated using month-ending balances from account 234.

15 Q. Is that the interest rate that you're
16 recommending for the retroactive approval for the debt
17 financing?

18 A. That's correct.

19 Q. And, Mr. Irvine, does the change in your
20 recommendations for the retroactive approval also change
21 your recommended capital structure?

22 A. Yes, it does.

23 Q. And do you have Staff Exhibit S-25 up there?

24 A. I do.

25 Q. Can you identify this for the record, please?

1 A. This is a set of schedules that I've used in
2 calculation of cost of capital that make certain
3 corrections and updates to my recommended cost of
4 capital.

5 Q. The first page with this exhibit, Mr. Irvine, is
6 this your updated capital structure recommendation and
7 weighted average cost of capital?

8 A. That's correct.

9 Q. Do you have any other additions, corrections, or
10 modifications to your prefiled testimony at this time?

11 A. There was a change in my surrebuttal testimony
12 in the table of contents. Section number 3, rather than
13 having page numbers, in two cases, where you see CAPM and
14 DCF, are marked as error, bookmark not defined.

15 That was a result of having changed those
16 acronyms from the acronym itself to the words that the
17 acronym represented, and it created this bookmark error.

18 So to create that, rather than using CAPM in
19 that spot, I would add the whole phrase "capital asset
20 pricing model," and the appropriate page for that
21 reference is page 5.

22 Similarly for DCF, rather than DCF I would
23 insert the words "discounted cash flow," and the
24 appropriate reference for that would be page 6.

25 Q. Mr. Irvine, could I direct you to Mr. Bourassa's

1 rejoinder testimony on page 20 at lines 11 through 13?

2 Mr. Bourassa claims that staff's use of all assets
3 financed by single pool of funds ignores CIAC and AIAC.

4 Do have you a response to Mr. Bourassa's claim?

5 A. I do. The AIAC and CIAC are artificially
6 assigned to particular assets under the universal system
7 of accounts to preserve the benefits for the rate payor
8 whose contribute those funds.

9 Debt differs in that it doesn't emanate
10 specifically from rate payors, and there should be no
11 such similar treatment for debt as there are for AIAC and
12 CIAC, being artificially assigned to particular assets.

13 Q. Could you turn to the company's rejoinder
14 testimony at page 21? I'm sorry, Mr. Bourassa's
15 rejoinder testimony. The question and answer that begins
16 on line 25, Mr. Bourassa criticized your reliance on a
17 study by Andy Wong related to firm size.

18 Would you like to respond to Mr. Bourassa's
19 criticism?

20 A. Yes. In his criticism, Mr. Bourassa makes
21 reference to a study by Thomas Zepp who presents evidence
22 that suggests that Ms. Wong's conclusions were not based
23 on strong evidence, and I've reviewed the Zepp article
24 and developed a number of concerns based on what I saw in
25 the Zepp article.

1 The Zepp article makes references to other
2 findings in other studies and doesn't offer a lot of
3 explanation about the methodology in those studies, and
4 from what I can see related to those studies, I have
5 concerns about the evidence that they're based on.

6 For instance, it makes reference to findings by
7 Ibbotson's that takes an annual measure of beta. In
8 contrast, Ms. Wong's study had made references to --
9 based her conclusions on measurements of monthly, daily,
10 and weekly measures.

11 Comparatively, when you look at something on an
12 annual basis, contrasted to something that takes more
13 frequent inputs, a study based on annual data results in
14 fewer samples, which increases the possibility of
15 sampling error.

16 So, on that basis, I was skeptical about the
17 Ibbotson's findings relative to those of Ms. Wong.

18 Q. In other words, those other studies discussed
19 the benefits of using annual data, but they didn't
20 necessarily discuss some of the downfalls like smaller
21 sample sizes?

22 A. That's correct. It did not -- Dr. Zepp's --
23 Mr. Zepp's paper, rather, did not mention the sample
24 size.

25 Q. Did Mr. Zepp's article have any of the original

1 data in it?

2 A. It did.

3 Q. Did you have any concerns about the original
4 data?

5 A. There was a table 1 which showed results from
6 consideration of three companies. Concerned about a
7 sample size of three and the possibility of sampling
8 error.

9 There was another study, table 2, which I
10 believe was based on evidence from a study of four
11 companies. Again, four is a small sample size, subject
12 to significant sampling error.

13 Q. Mr. Irvine, do you have any other comments you'd
14 like to add at this time?

15 A. I do not.

16 Q. Do you adopt Exhibits S-18, S-18A, and S-24,
17 S-25, and S-26 as part of your sworn testimony today?

18 A. I do.

19 MR. LAYTON: Your Honor, staff moves for the
20 admission of Exhibits S-18, S-18A, S-24, S-25, and S-26.

21 ALJ WOLFE: S-18 and S-18A will be admitted, as
22 there was no objection at the prehearing conference.

23 (Exhibits S-18 and S-18A were admitted into
24 evidence.)

25 MR. SHAPIRO: Is 18A the surrebuttal and 18 the

1 direct?

2 ALJ WOLFE: Yes.

3 Mr. Shapiro, do you have any objection to S-24?

4 MR. SHAPIRO: No.

5 ALJ WOLFE: Is there any objection to S-25 or
6 S-26 or S-24 by any of the parties?

7 MR. POZEFSKY: No, Your Honor.

8 MR. SHAPIRO: No.

9 ALJ WOLFE: S-24, S-25, and S-26 are admitted.
10 (Exhibits S-24, S-25, and S-26 were admitted
11 into evidence.)

12 MR. LAYTON: Your Honor, Mr. Irvine is now
13 available for cross-examination.

14 ALJ WOLFE: Thank you.

15 Mr. Pozefsky, does RUCO have questions?

16 MR. POZEFSKY: No, Your Honor.

17 ALJ WOLFE: Thank you.

18 Mr. Shapiro?

19 MR. SHAPIRO: Thank you.

20

21 CROSS-EXAMINATION

22

23 Q. (BY MR. SHAPIRO) Good afternoon, sir.

24 A. Good afternoon.

25 Q. Thomas Zepp has a Ph.D. in economics, doesn't

1 he?

2 A. I understand him to be a Ph.D. I'm not sure
3 that it's economics. If you'd like, I'll work under that
4 assumption.

5 Q. Somebody with a Ph.D. is entitled to use the
6 term "doctor," aren't they?

7 A. Yes.

8 Q. So you didn't mean to correct yourself and call
9 him a mister, did you?

10 You don't have to answer that.

11 How long have you been with the Corporation
12 Commission, Mr. Irvine?

13 A. Five years.

14 Q. What positions have you held in that time?

15 A. I have been a records examiner, examiner 1,
16 examiner 2, assistant supervisor, public utility analyst
17 2 and 3.

18 Q. When did you start doing cost-of-capital
19 analysis?

20 A. Roughly a year ago.

21 Q. How many cases have you testified in on cost of
22 capital?

23 A. This is my first cost-of-capital case.

24 Q. Don't you think you lack the experience as a
25 cost-of-capital analyst to criticize the works of a

1 gentleman like Dr. Zepp who has been doing cost of
2 capital for a couple of decades?

3 MR. LAYTON: Your Honor, I object to that
4 question. The number of years of experience isn't the
5 only relevant factor in his competence to provide
6 testimony in this. He can study the topic and educate
7 himself and work with other people to be able to gain the
8 expertise, and we believe he has the expertise.
9 Mr. Shapiro is implying that lack of years of experience
10 makes him not expert enough to testify on this topic.

11 ALJ WOLFE: There was no objection to admission
12 of his direct and surrebuttal testimony. The objection
13 will be sustained.

14 MR. SHAPIRO: Okay.

15 Q. (BY MR. SHAPIRO) Let me ask you, what makes you
16 think you're qualified to criticize the work of Dr. Zepp?

17 A. Well, I do have an understanding of statistics
18 and research methods, and I've made some general
19 observations about his article and mentioned concerns
20 that I've had.

21 Q. California PUC agrees that small utilities
22 should be treated differently for returns on equity than
23 larger utilities; isn't that correct?

24 A. That was a conclusion that was cited in
25 Dr. Zepp's article.

1 Q. Also referenced in Mr. Bourassa's rejoinder
2 testimony?

3 A. Actually, I don't recall, but I can work under
4 that assumption.

5 Q. It's at rejoinder testimony page 22. I'm
6 referring specifically to lines 2 through 5.

7 A. I can see that now that this testimony does make
8 reference to that determination.

9 Q. You don't have any basis or evidence to disagree
10 with that, do you?

11 A. I'm sorry, to disagree with what?

12 Q. With what the California PUC has found as
13 referenced by Dr. Zepp and Mr. Bourassa.

14 A. I have not personally conducted any analysis
15 relative to small-size effect, if you will.

16 And if I might establish for the record, with
17 your permission, my concern earlier between whether I
18 should use the word Dr. or Mr. Zepp arose from him not
19 having referred to himself as Dr. Zepp in his article.

20 Q. Wasn't intended to be a criticism?

21 A. Yes. I don't mean any disrespect for Dr. Zepp
22 for lack of having used his title. I just wanted to
23 correlate with his appropriate name as it was in the
24 article.

25 Q. You'll agree with me there is often a lot of

1 disagreement in this area, cost-of-capital analysis?

2 A. Absolutely.

3 Q. So you were expressing a disagreement with
4 Dr. Zepp and Mr. Bourassa, not a derogation of either of
5 them?

6 A. In what regards exactly?

7 Q. I think you explained. There wasn't a problem
8 with Dr. Zepp or his qualifications; you disagree with
9 his conclusions. Is that fair?

10 A. That's fair, yes.

11 Q. Mr. Layton stated that you have educated
12 yourself and trained to learn how to do cost-of-capital
13 analysis. What kind of training have you undertaken?

14 A. I've worked under the guidance of staffers who
15 have done this before and with the supervision of my
16 manager. Also done extensive reading, and I've been to
17 NARUC-sponsored seminars that have given instruction on
18 the cost of capital.

19 Q. Are there any courses you can take on the DCF
20 and the CAPM models?

21 A. I believe the CAPM is taught in certain finance
22 courses.

23 I'm sorry, did you ask me if I had taken them or
24 if one may take them?

25 Q. One may take them?

1 A. Certainly there are.

2 Q. Have you taken those courses?

3 A. I have taken courses in finance. I do not
4 recall specifically having been given specific
5 instruction as to the CAPM in an academic setting.

6 Q. When you started doing cost-of-capital analysis
7 here at the Commission, were you provided with the
8 testimony of prior staff witnesses who conducted
9 cost-of-capital analysis and testified?

10 A. I was.

11 Q. Were you provided with computer programs for
12 using staff's DCF and CAPM models?

13 A. I was.

14 Q. Okay. Now, you testified, and I'm referring to
15 your direct testimony at page 8, that Far West's proposed
16 capital structure was arbitrarily presumed. That's
17 correct?

18 A. Still getting to the page here.

19 Q. Okay.

20 A. If you might please suggest the line number.

21 Q. Yes, it's line 3.

22 A. That's correct. My testimony says: Single
23 division capital structures do not exist except as
24 arbitrarily presumed.

25 Q. You're referring to the company's proposed

1 capital structure in this case?

2 A. That was my reason for having included it was to
3 give some instruction on that matter relative to this
4 company in this case.

5 Q. And you claim that this arbitrarily presumed
6 capital structure, which you also call, I believe, in the
7 same paragraph artificial, complicates the rate case?

8 A. Yes.

9 Q. Can you tell me, Mr. Irvine, what plant that is
10 providing service to Far West sewer customers was
11 financed by debt, specific plant items?

12 A. I'm sorry, your question is if I can tell you
13 what specific plant items are financed by debt?

14 Q. What specific plant items that Far West is using
15 to provide service to its sewer utility customers was
16 financed by debt?

17 A. Well, staff's position is that all sources of
18 capital form a single pool and that --

19 Q. Mr. Irvine, I understand that. That wasn't my
20 question.

21 My question is very specific. Please tell me
22 what plant items this company uses to provide service to
23 its customers that the company went out and incurred debt
24 to pay for the cost of that plant.

25 I understand your position, and we'll be happy

1 to go through it, but my question wasn't what was staff's
2 position.

3 A. I cannot identify any particular piece of plant
4 financed by debt because I don't believe in that
5 construct. All capital finances all assets.

6 Q. Is there any sewer plant in general that is
7 financed by debt that you know of?

8 A. Well, given that all capital finances all
9 assets, then debt, to an extent, finances all plants --

10 Q. Please continue.

11 A. -- given that there is debt in the capital
12 structure.

13 Q. So you don't have any evidence of Far West ever
14 going out and borrowing money to build any sewer plant
15 that's in the rate base in this case, do you?

16 A. No.

17 Q. You said in your direct testimony today that
18 CIAC is artificially assigned after contributed by rate
19 payors. How do rate payors contribute CIAC? Does the
20 company bill on a monthly basis its rate payors for
21 contributions in aid of construction?

22 A. I'm sorry, can I ask you to repeat the question?

23 Q. I'm trying to understand your statement about
24 rate payors contribute CIAC. How do rate payors
25 contribute CIAC? Are they sent a bill for CIAC?

1 A. Well, rate payors contribute to AIAC and CIAC
2 through advances.

3 Q. Are you aware of any agreements between rate
4 payors and Far West requiring those rate payors to make
5 advances or contributions?

6 A. I'm aware that there are some funds through AIAC
7 or CIAC.

8 Q. But you don't really know the source of those
9 funds?

10 A. I only know that they exist. It wasn't part of
11 my study to find the source of those funds. I just
12 learned through a revenue requirement witness that they
13 existed.

14 Q. Well, let me ask this question. If a developer
15 approaches Far West and says, "I would like an extension
16 of service," and the developer and Far West enter into an
17 agreement called a main extension agreement --

18 You're familiar with those?

19 A. Yes.

20 Q. -- and the developer builds sewer facilities and
21 then conveys them to the utility under that agreement,
22 that's an advance in aid of construction; correct?

23 A. Yes.

24 Q. Don't we know exactly what the developer paid
25 for that plant when he conveys it?

1 A. Yes.

2 Q. And can't we attribute that exact amount to an
3 advance in aid of construction?

4 A. Yes.

5 Q. And don't we know whether that developer
6 provided an advance in aid of construction for purposes
7 of allowing the company to extend sewer utility service
8 versus extending water utility service?

9 A. Yes.

10 Q. Your capital structure in this case imputes --
11 I'm sorry. Let me rephrase that.

12 Your capital structure in this case includes
13 debt that you found on the company's books and records in
14 its 2004 annual report; correct?

15 A. That's correct.

16 Q. And the debt was a WIFA loan; correct?

17 A. The debt in my capital structure includes a WIFA
18 loan and some of the 234 account.

19 Q. So you have two components of debt, so we can
20 just kind of clarify, the WIFA loan and the accounts
21 payable that you're recommending be converted to debt
22 retroactively?

23 A. Correct.

24 Q. Let's talk about the accounts payable first. Is
25 there any kind of a loan or debt agreement or promissory

1 note associated with that debt?

2 A. There may be. There may or may not be. I'm not
3 actually certain of that.

4 Q. Do you have any evidence that the persons to
5 whom or the entity to whom those amounts are owed is a
6 willing lender?

7 A. Well, I reviewed the annual reports of both
8 H & S and Far West Water and Sewer, the reports filed to
9 our corporations division, and they identify the officers
10 and directors of each company as being the same
11 individuals. So, in terms of willingness, it's the same
12 individual who is both the lender and the debtor.

13 Q. So the fact that H & S has the same shareholders
14 as Far West leads you to the conclusion that those
15 shareholders are willing to loan money to Far West at any
16 interest rate this Commission approves? Did I understand
17 that conclusion correctly?

18 A. Well, I think I would probably rephrase it and
19 include some other information. H & S may choose or may
20 prefer to make an equity infusion, and staff would be
21 fine with that. Otherwise, those payments which extend
22 for long periods of time are, in effect, debt.

23 Q. H & S is not a shareholder in Far West, is it?

24 A. I'm not actually certain if that's the case.

25 Q. Well, if H & S was not a shareholder, then it

1 really can't make an equity infusion; correct?

2 A. I suppose that's up to the company, really.

3 Q. Well, the accounts payable that you're referring
4 to, those are amounts that were charged by H & S to Far
5 West's sewer division to build a plant; correct?

6 A. I know that there are payments. Exactly whether
7 or not they were used to build plants or for what
8 specific purposes, I don't recall. There are payments
9 from one side to the other, if that's what you're getting
10 at.

11 Q. You're not sure, though, specifically of the
12 source of those accounts payable that you found and are
13 converting to long-term debt? You just found them, and
14 this is the treatment of them, but you don't know how
15 they originated?

16 A. I know they originate from H & S given the
17 response to SI-11.1.

18 Q. Well, do you know whether those amounts paid by
19 H & S were used to cover operating expenses that Far West
20 was unable to pay?

21 A. Presumably some of the funds could be used for
22 that purpose and some of the funds could be used for
23 purchases of plant and equipment. I can go through the
24 list and read all the entries if that's what you'd like.

25 Q. Do you know if it's lawful for a regulated

1 utility to borrow money to pay operating expenses?

2 A. I believe that it's not.

3 MR. LAYTON: I didn't get a chance to insert my
4 objection before the answer.

5 I believe Mr. Shapiro asked Mr. Irvine for a
6 legal conclusion, and he's not an attorney.

7 ALJ WOLFE: Objection is noted for the record.

8 Q. (BY MR. SHAPIRO) Okay. The other debt, not the
9 accounts payable, the other debt that you've used in your
10 capital structure in this case, that was the WIFA loan;
11 correct?

12 A. Correct.

13 Q. Do you have Staff Exhibit S-10?

14 A. I do.

15 Q. The Commission approved this loan in decision
16 61713; correct?

17 A. I'm not certain of the actual decision number.

18 Q. You agree with me the Commission approved the
19 WIFA loan?

20 A. I agree with that, yes.

21 Q. And you agree with me that the Commission
22 directed the utility to use the money from that loan to
23 build a surface water treatment plant?

24 A. That's correct.

25 Q. And you would agree with me that on page -- the

1 first actual page of the loan agreement S-10, under
2 section 1-B, Purpose of Loan, it's consistent with the
3 borrowing of the money to build a surface water treatment
4 plant?

5 A. Correct.

6 Q. So we do know what the company did with the loan
7 from WIFA, don't we? They built a surface water
8 treatment plant; correct?

9 A. Well, on an incremental basis, yes, they
10 acquired money from the loan and they used it for
11 purposes of constructing the plant.

12 Q. You're not suggesting this company violated the
13 Commission's order or the express terms of the loan and
14 used the money for something else, are you?

15 A. I'm not, but in my conclusion that Far West
16 Water, the water delivery company and the sewer company
17 share a single capital structure and all sources of funds
18 for the plant, I do not also make the conclusion that the
19 company did not use the funds appropriately to construct
20 the water plant.

21 Q. If we're going to include the debt from Far West
22 Water Company, shouldn't we also be including the plant
23 from the water company, or the water division?

24 A. I'm not sure what you mean in terms of including
25 the plant.

1 Q. Well, isn't the goal to have the capital
2 structure for the utility whose rates we're setting match
3 the plant upon which the utility is entitled to earn a
4 return?

5 A. I am sorry, can I ask you to repeat the question
6 again?

7 Q. Yes.

8 Isn't a goal of the process that we're in to set
9 rates by matching the capital structure that finances the
10 utility's plant to the plant upon which the utility is
11 entitled to earn a return?

12 A. That is the case, yes.

13 Q. What interest rate did you use for the -- I'm
14 sorry. Let me strike that.

15 Let me just ask you to go back to the exhibits
16 that we introduced today and just make sure that I'm
17 clear and the record is clear.

18 Now, what is your current recommended capital
19 structure for Far West? Has it changed from your
20 surrebuttal testimony?

21 A. It has. It's shown in Exhibit S-25.

22 Q. What is it exactly, the actual capital structure
23 now? It's 44 percent debt, 56 percent equity?

24 A. That's correct.

25 Q. What was it in your surrebuttal testimony, or

1 direct testimony if it didn't change?

2 A. In my surrebuttal testimony, the capital
3 structure was originally shown at 48.1 percent debt and
4 51.9 percent equity.

5 Q. Okay. Thank you.

6 The interest rate that I found you using in your
7 prefiled testimony was 5.2 percent on that debt. Is that
8 still the interest rate you're using?

9 A. No, it is not.

10 Q. What's the interest rate you're using now?

11 A. The interest rate shown on S-26, 5.93 percent.

12 Q. What's the prime rate today?

13 A. 8.25 percent.

14 Q. What evidence do we have to present to this
15 Commission to show that Far West can borrow money today
16 at 5.93 percent?

17 A. I don't know that we have evidence that suggests
18 that they can go out to market and get that rate, but the
19 evidence that I've used to calculate 5.93 percent is the
20 effective rate that I can observe from the information
21 the company has provided me relative to account 234.

22 Q. So the interest rate that you're proposing for
23 the debt you propose to include in the capital structure
24 is based on your review of amounts that Far West has been
25 unable to pay its affiliate, H & S Developers; correct?

1 A. I can't comment on the ability to pay, but it's
2 amounts I've seen in the 234 account that are unpaid.

3 Q. Okay. Why not just put the debt into the rate
4 structure at current prime rate? Wouldn't that be a
5 better measure of what the company might be able to
6 borrow at?

7 A. I think that's actually a two-part question:
8 why not do it, and what could you get the rate at. If I
9 might, I'll divide the answers up based on those two.

10 Q. Sure.

11 A. In terms of why not, the reason I've chosen this
12 rate is because it is the effective rate of debt that we
13 observe in account 234 given the evidence that the
14 company has provided.

15 As far as the second question goes, isn't prime
16 rate more reflective of the rate that they would get in
17 the market currently? Yes.

18 Q. Do you know what WIFA's current rates are?

19 A. I've actually just recently done some financing
20 that analyzed those rates, and they actually vary based
21 on some internal discount rates they use. There is not a
22 single digit that I can cite.

23 Q. You're aware the company recently closed on a
24 short-term loan to build plant upgrades?

25 A. I'm actually not certain about that.

1 Q. You don't have any reason to dispute the
2 testimony of the company's president that the effective
3 rate of that loan was 8.6 percent, do you?

4 A. Not currently, no, I have no reason to dispute
5 that at all.

6 Q. Do interest rates factor the cost of equity,
7 Mr. Irvine?

8 I'm sorry, is it "ir-vine" or "ir-vin"?

9 A. Actually, it is "ir-vine," and I'm typically not
10 particular about that, but -- except here.

11 Q. Thank you for correcting me.

12 Do interest rates factor the cost of equity?

13 A. They do.

14 Q. In fact, based on your testimony at page 13, you
15 call that a positive relationship; correct? It's at page
16 13 of your direct. If I can direct you further, it's at
17 line 15, sir.

18 A. That is true. However, that carries the
19 assumption that all else remains equal.

20 Q. But I assume what you mean by that is as
21 interest rates go up, costs of capital go up. As
22 interest rates go down, costs of capital generally go
23 down. That's what you meant by a positive relationship?

24 A. That's true, all else being equal, I would say.

25 Q. And you would agree with me that interest rates

1 have gone up by somewhere between three and four hundred
2 basis points over the past three years since the historic
3 lows of 2002-2003?

4 MR. LAYTON: Mr. Shapiro, Your Honor, could you
5 specify which interest rates that you're asking the
6 question about?

7 MR. SHAPIRO: How about the interest rates that
8 staff uses in its calculations?

9 THE WITNESS: If you refer to page 12 of my
10 direct testimony, there is a chart that describes change
11 on the average yield of the 5-, 7-, and 10-year Treasury
12 rates, and you can see from July '03 to what is roughly
13 the present time they've increased from a little over 3
14 to a little over 5.

15 Q. (BY MR. SHAPIRO) So that's about a
16 200-basis-point change?

17 A. Yes.

18 Q. Do you have Mr. Bourassa's rebuttal testimony up
19 there, Mr. Irvine?

20 A. I do.

21 Q. Thank you. Could you turn to page 52?

22 A. I have.

23 Q. And again, Mr. Irvine, I'm not asking whether
24 you agree with any conclusions that are drawn from this
25 data. I'd just like to ask you if you have any reason to

1 dispute the data itself as contained in the chart on page
2 52.

3 A. I have not reviewed each of these cases, so, no,
4 I have no reason to dispute it.

5 Q. You don't have any reason to dispute that in the
6 Arizona water case shown as 7803, staff's recommended
7 return on equity was 9.2?

8 A. I have no reason to dispute it.

9 Q. What is your recommended return on equity in
10 this case?

11 A. 9.3 percent.

12 Q. Beta is an estimate of an individual stock's
13 market risk; correct?

14 A. That's correct.

15 Q. And market risk is the risk that changes in the
16 market as a whole will cause changes in the stock price
17 of a particular entity?

18 A. That's correct.

19 Q. On page 32 of your direct testimony, you testify
20 regarding the cost of equity for a regulated water
21 utility.

22 A. Was that my direct testimony, did you say?

23 Q. Yes, sir.

24 A. Now that I've arrived at the package, can I ask
25 you to repeat the question?

1 Q. First I want to just refer to your testimony.
2 You're testifying concerning the cost of equity for a
3 regulated water utility. That's the phrase you used,
4 "regulated water utility."

5 A. Can you refer to the line?

6 Q. It's line 14, sir.

7 A. You lost me.

8 Q. I haven't asked you a question yet.

9 A. Exactly. I was trying to indicate that --

10 Q. That's okay. I wasn't sure you were there yet.
11 Tell me, what do you mean by a regulated water
12 utility?

13 A. That would be a public service corporation
14 engaged in the business of providing water on a regulated
15 basis.

16 Q. How many regulated water utilities are there in
17 the United States?

18 A. I don't know the figure exactly.

19 Q. Do you know how many have stock that is publicly
20 traded on a national exchange?

21 A. I also don't know that figure exactly.

22 Q. Do you know how many water companies there are
23 in the state of Arizona that are regulated?

24 A. There are a lot of them, but I don't know the
25 exact number.

1 Q. Is "a lot" a technical term that financial
2 people use?

3 A. Sometimes.

4 Q. Do you know if any Arizona regulated water
5 utility is traded on a national stock exchange?

6 A. I believe that there is not.

7 Q. How many water companies were in your sample
8 group?

9 A. Six.

10 Q. And to expedite this, let me do it this way.
11 American States, California Water Service, and SJW Corp.,
12 those operate in California; correct?

13 A. SJW, California, and American; is that correct?

14 Q. American States, Cal Water Service, and SJW
15 Corp. Those all operate in California, and American
16 States has a subsidiary here; correct?

17 A. Okay, actually, I think there is two questions.

18 The second one, the answer to the second
19 question about American States having a subsidiary here,
20 I'm actually not certain of that.

21 Q. Okay. Do you know where American States'
22 companies operate?

23 A. Okay, again, that question is about American
24 States; is that correct?

25 Q. At this point the question is about whether --

1 yes, I think that is the last question. Where does
2 American States operate?

3 A. In California and apparently not Arizona, having
4 acquired Chaparral City Water of Arizona.

5 Q. Cal Water Service, where does it operate?

6 A. I'm not certain, but presumably California.

7 Q. And SJW?

8 A. I'm sorry, if I could go back to the last
9 question. When you said "Cal Water," you were referring
10 to California Water, the publicly traded company; is that
11 correct?

12 Q. Yes. I'm talking about the companies in your
13 sample group.

14 A. I'm sorry, you said "Cal Water." I was thinking
15 perhaps it was a different company, not having used its
16 formal name.

17 California Water operates in California,
18 Washington, New Mexico.

19 Q. And SJW?

20 A. California.

21 Q. Middlesex, where does it operate?

22 A. New Jersey. Delaware. New Jersey and Delaware.

23 Q. Connecticut Water Service -- Services?

24 A. New England.

25 Q. And you would agree with me that Aqua American

1 operates primarily in that same general area in a number
2 of states; correct?

3 A. "That same general area," you mean --

4 Q. New England. Northeast.

5 A. There is a number of states. I can read the
6 list if you like.

7 Q. It's actually 14 states, isn't it?

8 A. I can make that assumption or read the list.

9 Q. You can take that, subject to check.

10 With the exception of the subsidiary of American
11 States, none of the water companies in your sample group
12 operate in the state of Arizona?

13 A. That appears to be correct.

14 Q. Do these companies provide nonregulated
15 services?

16 A. They may. I believe that some of them do. I
17 can't recall exactly what the other services are, but I
18 recall reading that some of them do.

19 Q. Did you do any analysis to determine how
20 regulation in California, New Jersey, Connecticut,
21 Massachusetts, or any of the states that Aqua American
22 operates differs from regulation in Arizona?

23 A. I did not.

24 Q. Did you do any analysis to determine how the
25 size of the sample companies compares to the size of

1 Arizona water utilities or Far West being one of those
2 Arizona water utilities?

3 A. I did not.

4 Q. Do any of the companies in your sample group --
5 do the companies in your sample group have credit ratings
6 such as Moody's or Standard & Poor's?

7 A. Some of them do, yes.

8 Q. Does Far West have a credit rating?

9 A. I'm not certain of that.

10 Q. Back to your -- the statement we reviewed, the
11 testimony we reviewed on page 32, you used the term
12 "market" at the end of that answer to the question;
13 correct?

14 A. I'm sorry, is that page 32 of direct testimony?

15 Q. Yes, sir. Still in the same place we were
16 before, lines 14 and 15.

17 A. I apologize. I had actually closed it.

18 Q. Have to keep track of all the paper.

19 A. I think I made reference to another one between
20 now and the last time we looked at it. It's direct
21 testimony page 32, line 14, is it?

22 Q. Lines 14 and 15.

23 A. The question is, had I used the word market --

24 Q. No, I was referring to your testimony where you
25 used the word "market."

1 A. If you could please remind me of the question
2 itself.

3 Q. I haven't asked the question yet. I'll ask it
4 now.

5 Is Far West part of the market that you're
6 referring to in your statement at line 15 -- lines 14 and
7 15 on page 32?

8 A. No, it's not a publicly traded company in and of
9 itself.

10 Q. You're not aware of any Arizona water or
11 wastewater utilities that would be part of that market;
12 correct?

13 A. I understand the Chaparral we just looked at was
14 owned by a publicly traded company.

15 Q. What is the market risk of Far West's stock?

16 A. It is not -- it's not a traded stock, so there
17 is not any market risk.

18 Q. Do you know whether the CAPM and DCF models you
19 use in this case -- I believe you said earlier they were
20 provided to you by staff when you started to do
21 cost-of-capital analysis; correct?

22 A. Well, the electronic versions were. The models
23 themselves are a concept.

24 Q. Thank you.

25 Those DCF and CAPM models, are those, to your

1 knowledge, the same CAPM and DCF models that staff has
2 used to do cost-of-capital testimony in water and
3 wastewater utility cases for, let's just say, the past
4 four years?

5 A. They are.

6 MR. SHAPIRO: If I could just have a moment,
7 Your Honor.

8 ALJ WOLFE: Yes.

9 MR. SHAPIRO: Thank you, Mr. Irvine.

10 ALJ WOLFE: Mr. Layton, do you have redirect for
11 this witness?

12 MR. LAYTON: I do, but does Mr. Pozefsky have
13 any questions he wishes to ask?

14 MR. POZEFSKY: No.

15 ALJ WOLFE: I'm sorry. I thought I had already
16 asked.

17 MR. POZEFSKY: We don't. Thank you.

18

19 REDIRECT EXAMINATION

20

21 Q. (MR. LAYTON) Mr. Irvine, first of all, I want
22 to discuss your use of models and prior staff testimony
23 in preparation for this case. When you were reviewing
24 those models and prior staff testimony, did you
25 independently conclude that they were valid and useful

1 for your analysis in this case?

2 A. I did.

3 Q. Let's go next to your recommendations to
4 retroactively approve debt for the H & S Developers'
5 accounts payable. Is the reason that you're recommending
6 the 5.93 percent because of the fact the loan more or
7 less has already been made and the interest rate has
8 already been set?

9 MR. SHAPIRO: Your Honor, I'm going to object,
10 and I do so reluctantly, but I think it would be
11 appropriate for Mr. Layton to ask questions that are not
12 entirely leading and provide the witness the answer. I
13 know he can do it.

14 MR. LAYTON: Mr. Shapiro asked these questions.
15 I believe on redirect I can ask more leading questions.

16 MR. SHAPIRO: I think the result is Mr. Layton
17 is testifying, and I think that's unfair to the company,
18 and I'll stand by my objection.

19 ALJ WOLFE: You may answer the question.

20 THE WITNESS: I am sorry to ask this. Just to
21 be certain, can I have you repeat the question?

22 ALJ WOLFE: You might want to rephrase it if
23 you're going to ask it again.

24 MR. LAYTON: That's fine.

25 Q. (MR. LAYTON) You're recommending a retroactive

1 approval; is that correct?

2 A. That's correct.

3 Q. Is the reason that it's a retroactive
4 approval -- can you explain why it's a retroactive
5 approval?

6 A. Because these were based on events from 2004,
7 which is in the past, and that makes it retroactive
8 approval of events that occurred.

9 Q. And the interest rate, rather than -- you didn't
10 recommend an interest rate that's a current interest
11 rate; is that correct?

12 A. That's correct. It's based on calculations of
13 the account as it was in 2004.

14 Q. So if the loan has already been made, then the
15 interest rate would have already been set; is that
16 correct?

17 A. That's correct.

18 Q. Let's turn to capital structure now, Mr. Liu
19 (sic). First of all, let's clarify the concept of
20 capital structure first.

21 Is capital structure a financing concept or is
22 it a regulatory concept?

23 A. It's a financial concept.

24 Q. And in the financial world, how is that capital
25 structure applied? Is it applied to a legal entity?

1 A. Yes.

2 Q. For example, a corporation?

3 A. Yes, a corporation. My understanding, a legal
4 entity, a corporation, LLCs and such.

5 Q. The reason why -- is that part of your rationale
6 for recommending a capital structure that includes both
7 the water and sewer division in this case?

8 A. That's true. Far West is unusual in that it
9 provides both water services and sewer services under the
10 same corporate entity.

11 Q. And are there other facts that you reviewed that
12 you thought made it particularly appropriate to recommend
13 that capital structure in this case?

14 A. There are -- I had a conversation with Jay
15 Spectro, the executive director of WIFA, regarding the
16 existing WIFA loan, and the -- I asked him about his
17 understanding of the implications of the loan, and he
18 suggested to me that the existence of the WIFA loan to
19 the water company would create a requirement for the
20 sewer division to get permission to take on new debt.

21 Q. And do you have Staff Exhibit S-12 up there?

22 A. I do.

23 Q. Could you turn to page 2 of that exhibit?

24 A. Is page 2 -- there is --

25 Q. The July 7 letter.

1 A. The second page of the July 7 letter. Okay.

2 Q. Could you look in the first sentence of the
3 second-to-last paragraph?

4 A. The one that starts out: Pursuant to where it
5 is shown --

6 Q. Pursuant to section 11-A of the loan agreement.

7 A. Thank you.

8 Pursuant to section 11-A of the loan agreement
9 between WIFA and Far West Water and Sewer dated October
10 15, 1989, Far West requests that WIFA consent to the loan
11 proposed by Government Capital Corporation. The entire
12 loan will be used for the improvement of Far West Water
13 and Sewer and will include -- I'm sorry -- and will
14 increase not only the value of the company but the value
15 of the security held by WIFA.

16 Q. That's fine. Thank you, Mr. Irvine.

17 Now, your conversations with Mr. Spectro for his
18 interpretation of the loan agreement for restrictions it
19 places on the loan agreement, does this appear that the
20 company agrees with those restrictions?

21 A. When you say "the company," you mean Far West?

22 Q. Yes. Far West.

23 Isn't Far West seeking permission pursuant to a
24 provision of the loan agreement to incur debt for the
25 sewer division?

1 A. That seems to be the case.

2 Q. That's consistent with what Mr. Spectro told you
3 how he, as the director of WIFA, interprets provisions of
4 this loan agreement?

5 A. That's correct.

6 Q. Could you turn to the first attachment after the
7 letter?

8 A. The one that says --

9 Q. The statement of income. It's right after the
10 two pages of --

11 A. Yes, I have that here.

12 Q. Does this appear to be a consolidated income
13 statement for both the water and sewer division?

14 A. It does.

15 Q. And were you present or did you hear
16 Ms. Capestro's testimony about the company's ability to
17 obtain the \$11 million loan?

18 A. I heard portions of her testimony over the
19 intercom.

20 Q. Subject to check, Ms. Capestro testified that
21 Far West Water and Sewer probably couldn't get the loan
22 for the sewer division unless this income statement
23 included water division revenues.

24 A. That's correct.

25 Q. How does that affect your opinion for whether

1 the WIFA debt should be included in -- or your
2 recommendation to use the capital structure for the
3 entire corporation?

4 A. It confirms the need for use of an entire
5 capital structure, the application of the capital
6 structure, the corporate capital structure to the sewer
7 division in this rate case.

8 Q. So that -- what are the implications of the fact
9 that the company needed to rely on water division
10 revenues to get debt for the sewer division?

11 A. That the lender would perhaps expect those
12 revenues to be used in support of the debt.

13 Q. Thank you. So from a financial perspective,
14 could retained earnings of the sewer division
15 hypothetically be used to pay for the principal and
16 interest of the WIFA loan?

17 A. It would seem, yes.

18 Q. So really you have a complete commingling of the
19 financing for both the water and the sewer division;
20 isn't that correct?

21 A. Potentially, yes.

22 Q. Are those facts you think particularly relevant
23 to using capital structure for the entire corporation to
24 be able to set the cost of capital in this case?

25 A. They are.

1 Q. Earlier Mr. Shapiro asked you some questions
2 about H & S Developers during his line of questioning for
3 your recommendation of retroactively approving the debt.
4 One of those questions was whether or not you knew if
5 H & S Developers and Far West had the same shareholders.
6 Do you recall that questioning?

7 A. Actually, I don't. I'm sorry.

8 Q. Well, subject to check, will you accept that?

9 A. Yes, subject to check, I'll agree that that
10 exchange occurred.

11 Q. Again, you heard portions of Ms. Capestro's
12 testimony. Not necessarily all of it; correct?

13 A. I recall the conversation generally, yes.

14 Q. Subject to check, Ms. Capestro testified to a
15 couple of things. One, she confirmed that the directors,
16 the officers of Far West Water and Sewer are identical to
17 the directors and officers of H & S Development.

18 The other thing that she testified to was that
19 she was a 50 percent shareholder of Far West Water and
20 Sewer and a 20 percent shareholder of H & S Developers.

21 Do you think that that's a good reason to
22 carefully scrutinize the way this H & S Developers
23 provided debt to Far West Water and Sewer?

24 MR. SHAPIRO: Your Honor, I'll interpose an
25 objection. I think Mr. Layton has misstated

1 Ms. Capestro's testimony.

2 MR. LAYTON: Mr. Shapiro, how did I misstate her
3 testimony?

4 MR. SHAPIRO: I believe that Ms. Capestro
5 testified that she is a 49 percent shareholder in Far
6 West and a 15 percent shareholder in H & S.

7 MR. LAYTON: I'll stand corrected on that,
8 Mr. Shapiro.

9 MR. SHAPIRO: Record should be clear.

10 Q. (MR. LAYTON) The point, Mr. Irvine, is that we
11 know at the very least from Ms. Capestro's testimony that
12 she is a shareholder of both corporations. Isn't that
13 correct?

14 A. I'll add that I was concerned about the
15 relationship between the two companies and actually
16 independently verified from the annual reports to the
17 corporation division that the officers and directors of
18 the companies were one and the same for that very reason.

19 Q. And isn't it difficult to -- whether or not
20 there was a written loan agreement for the debt between
21 the two companies, the fact that you have this extreme
22 overlap between corporations, isn't it reasonable to
23 assume that it could be debt?

24 A. Yes.

25 Q. I want to ask you a couple questions now,

1 Mr. Irvine, to clarify your understanding of how CIAC and
2 AIAC are used. Mr. Shapiro asked you some questions
3 related to capital structure and Mr. Bourassa's
4 testimony.

5 Because CIAC and AIAC can be traced to -- from
6 particular rate payors to a particular plant, does that
7 necessarily mean that CIAC and AIAC are concepts that
8 should be used to determine capital structure?

9 A. Can I ask that you rephrase the question?

10 Q. Let me rephrase that.

11 For the proceeds that the company receives from
12 CIAC and AIAC, those monies would go into some kind of an
13 account that the company holds, like a savings account?

14 A. That's correct.

15 Q. And for the actual purchase of the plant, does
16 it necessarily have to be those funds, or could it be
17 other funds that are used for the construction of that
18 actual plant?

19 A. I'm actually not certain of that.

20 Q. Okay, Mr. Irvine, just have one or two more
21 questions on return on equity. Mr. Shapiro asked you
22 about some of the companies that you selected in your --
23 as proxy companies to calculate a return on equity for
24 Far West.

25 A. Yes.

1 Q. Do you recall that?

2 Isn't it an accepted method to use proxy
3 companies to determine cost of capital for utilities that
4 are not publicly traded?

5 A. Yes. The Commission has done that historically,
6 and I would add that the company itself used the very
7 same proxy companies.

8 MR. LAYTON: Thank you, Mr. Irvine. I have no
9 further questions.

10 ALJ WOLFE: Mr. Shapiro?

11 MR. SHAPIRO: Yes.

12

13 RECROSS-EXAMINATION

14

15 Q. (BY MR. SHAPIRO) To your knowledge, Mr. Irvine,
16 does Far West have a hook-up fee that it charges that is
17 treated as CIAC?

18 A. I'm not certain.

19 Q. If a developer builds a plant item or builds
20 facilities and then conveys title to the company, there
21 would be no funds that go into a bank account, would
22 there?

23 A. I'm not certain if that is so.

24 Q. If the developer conveyed the plant, presumably
25 the developer paid for the plant?

1 A. Yes.

2 Q. If the developer's cost of the plant is treated
3 as either an advance or a contribution, we know exactly
4 the amount of the advance or the contribution; right?

5 A. Right.

6 Q. And we can tie it to a specific piece of plant,
7 can't we?

8 A. Plant was conveyed. You can tie it to itself, I
9 guess. I guess the question is --

10 Q. Aren't CIAC and AIAC part of total
11 capitalization?

12 A. When you refer to total capitalization, can you
13 be more specific about that?

14 Q. CIAC is considered zero-cost capital; correct?

15 A. In what? In what context?

16 Q. Well, let's go back to this scenario we have.
17 The developer built a plant item, conveyed title to it to
18 the utility, and the utility didn't have to make any
19 refunds on that plant. The utility now has that plant.
20 It's using it to serve the customer, and it didn't cost
21 it anything to get the capital to build the plant;
22 correct?

23 A. Okay.

24 Q. Yes? You agree with me?

25 A. If it was conveyed and it didn't cost anything

1 to get the plant, I agree with that.

2 Q. Isn't that why we deduct CIAC from rate base in
3 the rate-making equation?

4 A. Did you say "dunk"?

5 Q. No. Deduct.

6 A. I'm sorry, I heard "dunk." Could you rephrase?

7 Q. Isn't it the fact that CIAC is zero-cost capital
8 the reason that we deduct CIAC from rate base in the
9 rate-making process?

10 A. That's correct.

11 Q. If I understood your response to Mr. Layton's
12 redirect, is it my understanding that the accounts
13 payable that you've included in capital structure are
14 assumed debt? You assumed they were debt between H & S
15 and Far West?

16 A. I see. I think I understand the question. Just
17 to be certain, because I want to be clear on the matter,
18 can I ask to you repeat it?

19 Q. Yes.

20 Is it my understanding from your testimony on
21 redirect that the debt you included in the capital
22 structure that arises from accounts payable is assumed to
23 be debt?

24 A. Given the evidence that we were supplied in
25 response to data request, it appears to be debt. If

1 you'd like to call that assumed, that's fine, but it
2 certainly appears to be debt.

3 Q. Does Far West have the same customers receiving
4 water service as receive sewer service?

5 A. I actually haven't taken a count to find out
6 whether there are some who receive one service or
7 another, but presumably there could be some who either,
8 by having their own septic system or their own well,
9 receive one service or the other. I'm not entirely
10 certain they are one and the same.

11 Q. So if I told you subject to check that Far West
12 serves twice as many water customers as sewer customers,
13 you would accept that, subject to check?

14 A. If you'd like to use that as foundation to go to
15 another question, I can assume that that's correct.

16 Q. And doesn't Far West file separate annual
17 reports for its water and its sewer divisions?

18 A. It files a single annual report to the
19 corporations division and files separate annual reports
20 to the utilities division.

21 Q. We're here setting rates for a utility company;
22 correct?

23 A. We are here setting rates for a utility company
24 that is part of a corporation.

25 Q. And we're setting rates for sewer service,

1 correct, not for water service?

2 A. That's correct.

3 Q. And isn't it true that the Commission's rules
4 regarding classifying utilities specifically segregate
5 water and sewer revenues when a provider provides both
6 services?

7 A. I believe that calls for an interpretation of a
8 rule, and I'm not sure I can answer that question. It
9 seems to be a legal question.

10 Q. Can you not answer it because you don't know or
11 because it's a legal question? Frankly, the latter is
12 Mr. Layton's purview. The former is yours. Do you know
13 whether the Commission's rules provide that as such?

14 A. Could we start again?

15 Q. Do you know whether the Commission's rules
16 regarding classification of utilities segregate revenues
17 between the provision of water and the provision of sewer
18 service for determining the classification of an entity
19 that provides both?

20 A. I believe the rules do.

21 Q. Thank you.

22 You testified on redirect regarding your
23 discussions with the representative from WIFA, and if I
24 understood you correctly, you said that the WIFA loan
25 requirements as you were -- as it was explained to you

1 require approval for the sewer entity to take on debt.

2 Is that a correct understanding of your testimony?

3 A. That's correct.

4 Q. So doesn't that tell us that WIFA used the sewer
5 entity and the water entity as somehow different?

6 A. In a certain sense, yes.

7 Q. Ms. Capestro testified that she and her sister
8 had to personally guarantee the recent loan that was made
9 to the company.

10 A. Is that a question? Are you asking if that's
11 the case?

12 Q. Do you recall that testimony?

13 A. I believe I heard that, yes.

14 Q. Would it be appropriate, if we were putting that
15 loan into the company's capital structure, to put the
16 capital structure that finances Ms. Capestro's and her
17 sister's assets --

18 A. Okay, let me ask you -- can I ask you to repeat
19 the question?

20 Q. Sure.

21 If the company was before this Commission
22 seeking to have rates set on a plant that was financed by
23 loans personally guaranteed by Ms. Capestro and the other
24 shareholders, would it be appropriate to bring the
25 capital structure supporting their personal assets into

1 the picture for the rate setting?

2 A. I'm sorry. I'm struggling because it's kind of
3 a long question. I got it all except for the last part.
4 Would it be appropriate to -- can you go from there?

5 Q. Let me ask it this way. Does the fact that
6 something is used for security on a loan mean that that
7 item should be included in the rate-setting process?

8 A. It lends evidence that it's part of the capital
9 used to support the entity.

10 Q. So when a lender says to the shareholders of the
11 company, if you want to borrow money, we need your
12 personal assets pledged, then we should also consider
13 those personal assets in the rate-making equation because
14 they lend evidence in the manner you just suggested? Is
15 that what you're saying?

16 A. I'm actually not certain about that. That's
17 kind of an unusual circumstance. I don't know that I
18 have an opinion about that.

19 Q. Your capital structure results in a lower
20 revenue requirement than if you would have used 100
21 percent equity; is that correct?

22 A. That's correct.

23 MR. SHAPIRO: Thank you, Mr. Irvine.

24 ALJ WOLFE: Is there anything further?

25 MR. LAYTON: Yes, Your Honor. Thank you.

1 FURTHER REDIRECT EXAMINATION

2

3 Q. (MR. LAYTON) Mr. Irvine, my first question is,
4 is debt typically cheaper than the cost of equity
5 capital?

6 A. Typically it is.

7 Q. If the sewer division could not obtain a debt
8 because of the WIFA debt, would that be inequitable to
9 the sewer division rate payors?

10 MR. SHAPIRO: Sorry, could I have that question
11 read back?

12 (Record read by the reporter.)

13 MR. LAYTON: I'm sorry, I'd like to rephrase it.

14 MR. SHAPIRO: Please.

15 Q. (MR. LAYTON) If Far West Sewer and Water
16 couldn't get debt to purchase sewer division assets
17 because of the WIFA loan, would that be inequitable to
18 the sewer division rate payors?

19 A. Yes.

20 Q. And it would be inequitable because the overall
21 cost of capital would be higher for the sewer division
22 rate payors; is that correct?

23 A. In a framework where they had a separate capital
24 structure, yes.

25 Q. And as far as the WIFA loan and the restrictions

1 that it placed on the entity, weren't the restrictions
2 placed on Far West Water and Sewer and not the water
3 division or the sewer division?

4 A. That's correct. It was the corporation that
5 responded to WIFA, so that's correct.

6 Q. So it wasn't a restriction on the water
7 division, it was the corporate entity itself?

8 A. Correct.

9 Q. So your understanding of the restrictions placed
10 on the WIFA loan, in conversations with Mr. Spectro, if
11 Far West Water and Sewer as a corporate entity wanted to
12 incur any new debt, no matter what assets it would use to
13 purchase with that debt, they needed to get permission
14 from WIFA to incur that debt?

15 A. That's correct because of the effect it could
16 have on an ability to pay.

17 Q. Again, Mr. Shapiro asked you some questions
18 about whether or not the personal capital structure of
19 Ms. Capestro, and I don't know if he also referred to
20 Ms. Sandy Braden or not, but if their personal capital
21 structure should be included in Far West Water and
22 Sewer's capital structure because they personally
23 guaranteed the \$11 million. Do you recall that question?

24 A. I recall.

25 Q. Once again, going back to that, to a basic

1 financial concept, Mr. Irvine, is capital structure
2 related to a legal entity?

3 A. Yes.

4 Q. So a capital structure for a shareholder would
5 be irrelevant to the capital structure for Far West Water
6 and Sewer, wouldn't it?

7 A. That's correct.

8 MR. LAYTON: Thank you, Mr. Irvine. I have no
9 further questions.

10 ALJ WOLFE: Mr. Shapiro?

11 MR. SHAPIRO: No.

12 ALJ WOLFE: Thank you for your testimony,
13 Mr. Irvine. You're excused as a witness. And we'll take
14 a 15-minute break.

15 (Recess at 2:11 p.m.; resumed at 2:32 p.m.)

16 ALJ WOLFE: Mr. Layton, are you prepared to call
17 your next witness?

18 MR. LAYTON: Yes, Your Honor. Staff calls
19 Ms. Brown.

20 / /

21

22

23

24

25

1 CRYSTAL BROWN,
2 A witness called on behalf of Staff, having first been
3 duly affirmed by the Court Reporter to speak the truth
4 and nothing but the truth, was examined and testified as
5 follows:

6

7

DIRECT EXAMINATION

8

9 Q. (BY MR. LAYTON) Good afternoon, Ms. Brown.

10 A. Good afternoon.

11 Q. Could you state your full name and business
12 address for the record?

13 A. My name is Crystal S. Brown. My business
14 address is 1200 West Washington, Phoenix, Arizona, 85007.

15 Q. By whom and in what position are you employed?

16 A. I'm employed by the Arizona Corporation
17 Commission. I am a public utility analyst 5 employed in
18 the financial and regulatory section -- analysis section.

19 Q. Could you briefly describe your duties in that
20 position, Ms. Brown?

21 A. My primary duty is to process rate applications.

22 Q. In the course of your employment, did you review
23 and evaluate a request for rate increase from Far West
24 Water and Sewer?

25 A. Yes.

1 Q. Did you prepare and prefile any testimony in
2 this case?

3 A. Yes.

4 Q. Do you have before you a staff exhibit
5 previously marked as S-22 and S-23?

6 A. Yes.

7 Q. Could you identify these exhibits for the
8 record?

9 A. S-22 is my direct testimony.
10 S-23 is my surrebuttal.

11 Q. And were S-22 and S-23 prepared by you or under
12 your direction?

13 A. Yes.

14 Q. Do you have any additions, corrections, or
15 modifications to those exhibits at this time?

16 A. Yes. I corrected the depreciation expense
17 calculation on Schedule CSB-17, column E, line 24. There
18 was an error in that calculation. I corrected that.
19 Also, I reflected staff's revised weighted average cost
20 of capital.

21 Q. And, Ms. Brown, you filed with the docket an
22 update of those schedules?

23 A. I will do that.

24 And there was another correction. I corrected
25 the weighted average cost of debt also.

1 Q. Are all of those corrections included in the
2 copies that we've provided to the company?

3 A. Yes.

4 Q. Do you have a copy of Staff Exhibit S-14 up
5 there?

6 ALJ WOLFE: Did you say S-14?

7 MR. LAYTON: Yes.

8 THE WITNESS: Yes, I do.

9 Q. (MR. LAYTON) And, Ms. Brown, is this the
10 documentation you received from the company which you
11 relied upon for your recommended disallowance related to
12 affiliate profit?

13 A. Yes.

14 Q. Do you have any comments that you'd like to make
15 about this exhibit?

16 A. Yes, I would like to point out the company
17 stated it did not keep detailed job costing records as it
18 states in note 1.

19 Q. Do you have Staff Exhibit S-27 up there?

20 A. Yes.

21 Q. And could you please identify it for the record?

22 A. It is the company's response to staff's request
23 for information on its -- on the company's organizational
24 chart.

25 MR. SHAPIRO: May I ask -- excuse me -- may I

1 ask, Your Honor -- I know that staff didn't ask
2 Mr. Bourassa any questions on this issue. Is Ms. Brown
3 responding -- what is Ms. Brown responding to in what
4 appears to be lengthy direct examination and numerous
5 exhibits?

6 ALJ WOLFE: I'm a little confused too.

7 MR. LAYTON: Mr. Bourassa was asked a number of
8 questions about affiliate profit, and Ms. Brown --
9 related to Ms. Brown's testimony.

10 MR. SHAPIRO: Asked by whom? You didn't ask him
11 a single question on the issue, and we didn't do any
12 redirect on the issue. Certainly staff will have a
13 redirect if we get into the subject.

14 MR. LAYTON: Actually, the questions were asked
15 of Ms. Capestro, not Mr. Bourassa. I stand corrected on
16 that. But I'm just asking Ms. Brown to sponsor this
17 exhibit because it is related to her and a data request
18 that she was analyzing, the affiliate transaction between
19 H & S Developers and Far West Water and Sewer.

20 MR. SHAPIRO: I guess I would ask if staff could
21 defer this to their redirect examination. I don't know
22 that any of this will be germane to the issues in
23 dispute. I haven't asked her a single question yet.
24 Seems like what they are doing is a pretty lengthy and
25 substantial direct examination of the witness at the

1 hearing. She has filed two rounds of testimony and in
2 great detail explained her position.

3 ALJ WOLFE: Mr. Layton?

4 MR. SHAPIRO: If I may -- apologize -- I also
5 would point out I assume all of these exhibits have been
6 in staff's possession for some time, well before they
7 filed, I believe, based on looking at either of their
8 prefiled testimonies.

9 Thank you. I didn't mean to interrupt.

10 ALJ WOLFE: Would you like to respond,
11 Mr. Layton?

12 MR. LAYTON: Your Honor, these issues have been
13 discussed throughout the hearing, and staff believes that
14 Your Honor and the Commission should have all of the
15 evidence provided to staff that relates to the issues
16 that we've been discussing throughout this matter. If
17 you want to exclude it because we didn't ask Mr. Bourassa
18 directly a question about that -- but we did ask
19 Ms. Capestro questions about the overlap of the two
20 corporations, and this is evidence that they provided for
21 how they're organized among those two organizations and
22 other affiliates that they're requesting recovery of
23 costs for.

24 MR. SHAPIRO: The company will stipulate there
25 are common shareholders between H & S Developers and Far

1 West Water and Sewer. The company will further stipulate
2 that when H & S builds things for Far West, it charges an
3 amount that is above the cost of time and materials.
4 Those issues are not in dispute.

5 Again, I think staff is taking an opportunity to
6 further bolster its case, and it will have redirect after
7 I have an opportunity to cross-examine this witness on an
8 issue that I think they're going well beyond the scope of
9 our rejoinder and the scope of what the direct
10 examination at this stage is supposed to be. Not trying
11 to foreclose Mr. Layton from using these in redirect if
12 he thinks they're pertinent.

13 ALJ WOLFE: Mr. Layton, I would assume that
14 these exhibits that have been premarked that are here on
15 the bench in front of me were used by Ms. Brown, relied
16 on by her in preparation of her direct and surrebuttal
17 testimony?

18 MR. LAYTON: Yes, Your Honor, and that's the
19 primary reason why we're asking Ms. Brown to provide
20 these responses to data requests now because she relied
21 upon them in her prefiled testimony.

22 The information isn't -- I mean, the company
23 provided it. It's not like it's a problem with notice or
24 anything like that.

25 ALJ WOLFE: I understand. But in the interests

1 of time, we already have her testimony in front of us,
2 and I do agree that if these issues come up on
3 cross-examination, that it may be appropriate to enter
4 evidence into the record, additional evidence. But right
5 now maybe we should just go on her prefiled testimony.

6 MR. LAYTON: We'll withdraw it. We'll withdraw
7 the exhibits then.

8 ALJ WOLFE: Not saying they couldn't be used at
9 a later time if necessary.

10 Q. (MR. LAYTON) Ms. Brown, have you reviewed
11 Mr. Bourassa's rejoinder testimony?

12 A. Yes.

13 Q. Could you turn to page 16?

14 Could you review the question and answer that
15 begins on line 6?

16 A. What is the reference?

17 Q. Page 16, the question and answer beginning on
18 line 6. In this answer, Mr. Bourassa criticized staff's
19 averaging in the test year with the two prior years for
20 the costs of repair and maintenance; is that correct?

21 A. That's correct.

22 Q. Could you turn to Schedule CSB-15 in your direct
23 testimony?

24 A. I have it.

25 Q. Could you explain this schedule and the basis

1 for this type of averaging?

2 A. This schedule reflects the company's repair and
3 maintenance expense for the three -- for the test year
4 and two prior years. Staff noticed a very large increase
5 from the prior year, 2003. Therefore, in order to
6 normalize the expense level, staff averaged the three
7 prior years.

8 Q. Just a moment, Ms. Brown.

9 A. Normalizing is an accepted Commission
10 rate-making adjustment.

11 Q. Ms. Brown, other than the affiliate profit
12 issues, are there any other remaining disputes between
13 staff and the company on issues related to rate base,
14 revenue requirement, or operating expenses?

15 A. There is the working capital issue and rate
16 base, and, as you just pointed out, the repair and
17 maintenance in operating expenses.

18 Q. And do you have any further comments on any of
19 those issues, Ms. Brown?

20 A. No. Not at this time.

21 MR. LAYTON: Staff moves for the admissions of
22 Exhibits S-22 and S-23.

23 ALJ WOLFE: S-22 and S-23 are admitted as there
24 was no objection.

25 (Exhibits S-22 and S-23 were admitted into

1 evidence.)

2 MR. LAYTON: Ms. Brown is now available for
3 cross-examination, Your Honor.

4 ALJ WOLFE: Mr. Pozefsky, do you have questions
5 for this witness?

6 MR. POZEFSKY: I don't, Your Honor, thank you.

7 ALJ WOLFE: Mr. Shapiro?

8

9 CROSS-EXAMINATION

10

11 Q. (BY MR. SHAPIRO) Good afternoon, Ms. Brown.

12 A. Good afternoon.

13 Q. Let's start with working capital and see what we
14 can agree on.

15 You would agree with me that lead-lag studies
16 increase rate-case expense; correct?

17 A. Not necessarily.

18 Q. Do they take time to prepare?

19 A. Yes, they do.

20 Q. Mr. Bourassa testified they take -- well, maybe
21 he didn't. They do take time to prepare.

22 You would also agree with me Mr. Bourassa is not
23 the creator of the formula method for determining working
24 capital; correct?

25 A. Correct.

1 Q. Let's just talk for a moment about normalization
2 of expenses.

3 In the process that the Commission follows to
4 set rates, the test year is presumed normal; correct?

5 A. No.

6 Q. The test year is presumed abnormal?

7 A. The test year is the year in which we begin.
8 Costs in the test year, certain costs in the test year
9 can be abnormal.

10 Q. That's true. But the starting point is a
11 presumption that the test year is reflective of the
12 company's normal expenses, isn't it?

13 A. I would not agree with that statement.

14 Q. That's fine. Thank you.

15 We do remove nonrecurring, inappropriate, and
16 abnormal expenses from test-year expenses; correct?

17 A. Correct.

18 Q. We make adjustments based on known and
19 measurable changes; correct?

20 A. Yes.

21 Q. Is an average a known and measurable change to
22 the test year?

23 A. When -- yes, it would be.

24 Q. You would agree with me that Far West is growing
25 at a very rapid pace?

1 A. You would have to define a "rapid pace."

2 Q. Have you reviewed Mr. Liu's testimony in this
3 case and his growth chart?

4 A. I would have to look at it once again.

5 Q. If I told you, subject to check, that he showed
6 over 400 percent growth in the past five years, would you
7 accept that, subject to check?

8 A. Yes.

9 Q. When you add customers, you add plant to serve
10 those customers?

11 A. Not necessarily.

12 Q. Okay. Far West is adding a substantial amount
13 of plant to its facilities, isn't it?

14 A. What do you define as substantial?

15 Q. Well, you heard them they're borrowing up to \$22
16 million to build all the facilities identified in
17 Mr. Lee's engineering report. Would you consider \$22
18 million in new plant substantial?

19 A. Yes, I would.

20 Q. In general, doesn't more plant usually mean more
21 operating expenses?

22 A. Not necessarily, because all plant has inherent
23 with it repair and maintenance costs. New plant may
24 operate more efficiently and may not have those
25 associated costs.

1 Q. So if the new plant has, for instance, membranes
2 that have to be maintained and repaired on a fairly
3 regular basis, would your testimony still be the same, or
4 you don't know how those membranes work?

5 A. The latter.

6 Q. Do you have any evidence that you can present to
7 the Commission demonstrating that the test year level of
8 repairs and maintenance expense was nonrecurring or
9 included nonrecurring amounts?

10 A. I have some evidence that it was not normal.

11 Q. That wasn't my question. My question was, do
12 you have evidence it was nonrecurring.

13 Let me ask it this way, Ms. Brown. Did you
14 normalize by averaging three years because you found that
15 the expense level in the test year was nonrecurring?

16 A. No.

17 Q. Did you normalize because you found that the
18 expense incurred was inappropriate?

19 A. No.

20 Q. You believed it was abnormal, the amount in the
21 test year; correct?

22 A. Yes.

23 Q. And that was only based on -- that was based
24 simply on the fact it went up from the two prior years;
25 correct?

1 A. No.

2 Q. Okay. Well, what basis was it on?

3 A. As you may be aware, I am working on three sewer
4 rate cases. That is the Black Mountain rate case, Gold
5 Canyon, and Far West. I noticed in all three of them
6 there was a significant increase in sludge removal
7 expense for all three of them.

8 Q. Are we talking about sludge removal expense,
9 Ms. Brown, or repairs and maintenance?

10 A. Well, the company includes that in its repairs
11 and maintenance.

12 Q. Can you show me in the income statement where
13 that's the case in your income statement?

14 A. Well --

15 Q. I mean, are you sure of that?

16 A. Okay, I'm not sure.

17 Q. So could we talk about repairs and maintenance
18 expense in this case, please?

19 A. When I reviewed the company's repairs and
20 maintenance, I saw costs that should be capitalized,
21 that -- or that could have been capitalized and that had
22 not occurred in the prior two years.

23 Q. You removed capitalized -- you removed items
24 that should have been capitalized, correct, before you
25 averaged?

1 A. Well, some, yes.

2 Q. And Mr. Bourassa accepted your adjustment to
3 remove expenses that should have been capitalized;
4 correct?

5 A. Yes.

6 Q. Okay. Why did you average the remaining amount
7 over three years? Because it was too high in the test
8 year?

9 A. If I could get my work papers I could tell you.

10 Q. Ms. Brown if you don't know why you made your
11 adjustment, then please just say so.

12 A. I said if I could get my work papers, I could
13 tell you. If we could take a break, I could pull them
14 out and I can tell you.

15 Q. As you sit here on the stand right now, you
16 don't know why you averaged 2002, 2003, and 2004 in order
17 to come up with an average; is that correct?

18 A. I would need my work papers.

19 Q. Do you have any evidence that your recommended
20 level of repair and maintenance expense bears any
21 relationship to the level of expense the company will
22 incur when the new rates approved in this case are in
23 effect?

24 A. Would you repeat the question?

25 Q. Yes. Do you have any evidence that your

1 recommended level of repairs and maintenance expense
2 bears a relationship to the level of expense that the
3 company will incur when rates -- when new rates are in
4 effect?

5 A. Well, the Commission uses the historical tested
6 concept, and it's presumed that the historical test year
7 will provide a sufficient amount of revenue on a
8 going-forward basis.

9 Q. But Ms. Brown, the first question I asked you on
10 the subject is whether the test year is presumed normal,
11 and you said no.

12 A. With pro forma adjustments. I made a pro forma
13 adjustment to make the test year more reflective of
14 expenses that are expected to occur in the future.

15 Q. What was the known and measurable change after
16 the test year that led you to make the adjustment you
17 made?

18 A. I did not state that I made the -- I don't
19 believe I stated that I made the adjustment because a
20 change happened after the test year.

21 Q. But you did state that the test year is presumed
22 normal subject to known and measurable changes. So I
23 guess I'm asking you, then, your adjustment should be
24 based on a known and measurable change, shouldn't it?

25 A. Not -- for example, certain pro forma

1 adjustments are made that are -- are based on analytical
2 techniques such as averaging, and items that are averaged
3 are based upon historical information.

4 For example, Far West's water division has
5 tanks, that the tanks must be painted, and tank
6 maintenance expense is averaged on a historical basis.

7 So in your question, what is known and
8 measurable, the amounts that were incurred in the test
9 year and the two prior years were known and measurable.

10 Q. Why not average 2003, 2004 -- the test year --
11 and 2005? Wouldn't that work?

12 A. I did not audit 2005.

13 Q. Did you ask for that information to see if your
14 adjustment bears any relationship to the expense that the
15 company is going to incur when the rates in this case are
16 in effect?

17 A. Staff believes that the company will be able to
18 earn its authorized rate of return given staff's revenue
19 requirement. If the company does not, then the company
20 can come in for rates.

21 Q. You recommended \$106,000 for this expense level;
22 correct? It's CSB-13.

23 A. Yes.

24 Q. If the company incurs in the first year the
25 rates are in effect in this case \$136,000, it would be a

1 \$30,000 shortfall; correct?

2 A. Not necessarily.

3 Q. Well, there would be a \$30,000 shortfall on this
4 expense?

5 A. For that expense, but that's --

6 Q. That's my question, Ms. Brown. There would be a
7 \$30,000 shortfall in your expense; correct?

8 A. Yes, but --

9 Q. If I understood your earlier testimony, your
10 suggestion is the company should just come in for a rate
11 case to get that extra money.

12 A. But companies do not operate in a vacuum. One
13 expense may go up, and another may go down, like the
14 property taxes that the RUCO pointed out. They may not
15 have in the test year the property -- next year, they may
16 not have the property taxes that staff averaged. We
17 averaged three years. That included the test year and
18 two future years. So in that case, you know, one might
19 offset the other.

20 Q. Are you suggesting that we don't have to be
21 accurate because expenses go up and down after the test
22 year and it will all wash out? Is that what you're
23 suggesting?

24 A. No, what I'm saying is that your question, which
25 seems to say that just because the company had a

1 shortfall in one expense that overall they'd have a net
2 shortfall.

3 Q. I didn't say net. I responded to your testimony
4 that you said all they have to do is come in for another
5 rate case. I asked, if they're \$30,000 short on this
6 expense, is your solution that they file a rate case?

7 A. You -- if their net operating income was such
8 that they were in a financial distressful position to
9 where they could not pay or continue as a going concern,
10 I would say they should come in for rates.

11 Q. Let me hand you what's been marked as Exhibit
12 A-8. Based on this exhibit, Ms. Brown, what was the
13 company's repair and maintenance expense for the sewer
14 division in 2005?

15 A. It was \$149,825.94. That's what the company
16 claims. This number has not been audited.

17 Q. Okay. Far West employees perform all of the
18 company's operations, don't they?

19 A. Yes. Well, the company does have some contract
20 services.

21 Q. But generally there is not an affiliate company
22 that performs all of the day-to-day operations of the
23 company? There are employees of Far West that do that?

24 A. Yes.

25 Q. And you agree with me that utilities like Far

1 West are not likely to build their own plant?

2 A. Correct.

3 Q. You would agree with me that in order to build
4 plant, they're likely going to have to contract with
5 somebody else to design and construct plant improvements?

6 A. Yes.

7 Q. You would agree with me that persons and
8 entities in the business of designing and constructing
9 sewer utility facilities expect to be paid for their
10 services, won't you?

11 A. Yes.

12 Q. You would agree with me that if those persons
13 and entities are going to stay in business, they need to
14 earn enough to cover their costs and earn some profit?

15 A. All of my responses to your previous questions
16 along this issue were yes only if we are talking about an
17 independent third-party contractor.

18 Q. Ms. Brown, I'm just talking in general, and you
19 answered the questions. Would you like to change your
20 testimony?

21 A. I just did.

22 Q. So you're qualifying your testimony?

23 A. Yes, sir.

24 Q. Okay. For a construction company, the costs
25 that a construction company is likely to incur are,

1 first, the cost of time and materials; correct?

2 A. That is correct.

3 Q. And on a job-by-job basis, a construction
4 company knows the cost of its time and materials for that
5 specific job; correct?

6 A. Not necessarily.

7 Q. Well, if I agree -- if I'm a construction
8 company and you ask me to build a barn for you, I do know
9 how much I spent on the materials I need and the people
10 that I pay to build the barn; correct?

11 A. Not necessarily.

12 Q. Why wouldn't I?

13 A. If you don't keep track of it. If you don't
14 have controls in place to keep in track. Just like Far
15 West. Far West said they don't need records, so they
16 don't know. It's impossible to know. If they don't
17 know, how can we know?

18 Q. You just said you're answering these questions
19 about a generic company, a nonaffiliate company. So
20 we're not talking about that entity, are we?

21 A. No.

22 Q. A construction company that is going to build a
23 barn for somebody can generally determine how much it
24 spent on the materials it needs to build the barn and on
25 the time -- on the payment to the people that built the

1 barn; right?

2 A. Only if it keeps track of it.

3 Q. Okay. So if it keeps costs of those records,
4 then it will know. And it can do that on a job-by-job
5 basis?

6 A. Yes, it can.

7 Q. It knows how much it spent on materials for your
8 barn. It knows how much it spent on materials for
9 Mr. Layton's sewer plant, if it keeps track.

10 A. If it keeps track.

11 Q. Now, these construction companies that are
12 building Mr. Layton's sewer plant and your barn, they're
13 also, in addition to the cost of time and materials, are
14 going to have costs associated with running a company;
15 correct?

16 A. Yes.

17 Q. That would include such things as, for instance,
18 the costs of running an office where its employees work?

19 A. That's correct.

20 Q. You would expect to see rent and utility and
21 supply costs and those costs; correct?

22 A. Only if they have them.

23 Q. You would expect to see the salaries and wages
24 of office staff and managers if they have them?

25 A. If they worked on those construction projects, I

1 would expect to see them. If they did not, I would not
2 expect to see them.

3 Q. That's my question. They have an office that's
4 there all the time irrespective of how many jobs they
5 have; correct?

6 A. Correct.

7 Q. The office's receptionist doesn't go out to the
8 job and pound nails. Presumably she stays in the office,
9 answers the phone for the next guy who wants to build a
10 barn; right?

11 A. Are you saying that those costs should be
12 allocated to those construction projects?

13 Q. Again, Ms. Brown, I think you're reading far too
14 much into my questions. They're very simple questions,
15 and that's -- this company that's in the business of
16 constructing things for people that hire them to
17 construct things has an office, and that office is likely
18 to incur certain types of costs irrespective of the
19 number of jobs that it does; correct?

20 A. Yes.

21 Q. Those costs are going to include things like the
22 cost of running an office; correct?

23 A. Yes.

24 Q. Taxes?

25 A. Yes.

1 Q. That would include payroll taxes?

2 A. Yes.

3 Q. Benefits for its employees and officers and
4 managers?

5 A. Yes.

6 Q. Insurance?

7 A. Yes.

8 Q. Cost of workman's comp?

9 A. Those are typical costs.

10 Q. Postage and freight, another typical cost?

11 A. Yes.

12 Q. Bad debt, another typical cost that we see?

13 A. Yes.

14 Q. Now, does this construction company that we're
15 talking about, does it incur the cost for workman's comp
16 in order to build your barn?

17 A. Yes.

18 Q. Doesn't it also incur that cost in order to
19 build Mr. Layton's sewer plant?

20 A. Yes.

21 Q. And if it built Mr. Moore another barn, it will
22 incur that cost in order to have the person around that
23 can do that; right?

24 A. For an independent third party, yes.

25 Q. But if it doesn't, it doesn't incur that cost

1 simply because it agreed to build your barn, does it?

2 A. It must build the barn.

3 Q. Well, you asked it to build a barn. It has to
4 go out and buy the materials it needs to build the barn?

5 A. Correct.

6 Q. It has to find the people to put the barn
7 together?

8 A. Yes.

9 Q. But it has already paid, presumably as part of
10 its company, its workman's comp; correct?

11 A. For those individuals that are already there.

12 Q. Right.

13 So it didn't incur workman's comp costs simply
14 because it agreed to build your project. That's part of
15 the company's expenses of running a company that's
16 available when you call and ask it to build a barn?

17 A. That's correct.

18 Q. And that's the same with the costs that we just
19 discussed -- taxes, salaries, and wages -- those costs
20 are there. They're not incurred by the company simply on
21 a job-by-job basis like time and materials are, you
22 agreed earlier.

23 A. Well, most of those are not.

24 Q. Most of those are not incurred on a job-by-job
25 basis?

1 A. Right.

2 Q. In fact, these costs we're talking about, aren't
3 these costs that are typically considered, in the
4 business world, overhead costs?

5 A. Some of them are.

6 Q. They're the costs that it requires me, the
7 construction company, to have a company that's available
8 when you call about a barn and Mr. Layton calls about a
9 sewer plant?

10 A. They're some of those costs, yes.

11 Q. Well, which one of the costs we talked about are
12 not overhead? Is it bad debt?

13 I'm just going back to my list. Let's just go
14 through the ones I asked you about earlier.

15 Is bad debt not an overhead cost?

16 A. This is marked as Exhibit S-32.

17 Q. Again, Ms. Brown, I've asked you a specific
18 question, and you're referring to some other document.

19 Is bad debt considered an overhead cost?

20 A. No.

21 Q. It's not? So what kind of cost is it for a
22 construction company?

23 A. In Exhibit S-32, we have the NARUC uniform
24 system of accounts, accounting instruction number 15,
25 utility overhead construction costs.

1 Q. Is H & S or a construction company subject to
2 NARUC?

3 A. NARUC has identified construction costs that are
4 typical to any construction company, not only utility
5 construction companies.

6 Now, the NARUC identifies overhead construction
7 costs such as engineering supervision, general office
8 salaries and expenses, construction, engineering and
9 supervision by others than the account utility, legal
10 expenses, insurance, injuries and damages, relief and
11 pensions, taxes, and allowance of funds used during
12 construction.

13 Q. Let me ask you my question again, because you
14 don't want to answer it.

15 Is a construction company that builds plant for
16 a utility company subject to NARUC in your opinion?

17 A. It's not subject to NARUC --

18 Q. Thank you.

19 A. -- but these costs are typical for any
20 construction company, whether it's regulated or
21 unregulated.

22 Q. Okay. How many construction companies does the
23 Commission's utilities division regulate?

24 A. The Commission regulates utility companies that
25 may have some construction component to it.

1 Q. Okay. So can you now please explain to me your
2 testimony earlier that bad debt is not considered an
3 overhead expense for a construction company? That's
4 simply because it's not in the NARUC category of
5 overhead? Is that the basis for your testimony?

6 A. The basis for my testimony is that bad debt
7 expense would have to be looked at because we do not
8 want, in the case of a --

9 Q. You didn't answer my question. I asked you
10 whether bad debt is an overhead expense. You told me, if
11 you went to the NARUC sheet --

12 Is bad debt an overhead expense that a
13 construction company will incur? Yes or no.

14 A. That is something that a utility and
15 construction company could incur, yes.

16 Q. In fact, we include bad debt as an item of
17 operating expense for utilities, don't we?

18 A. Yes, we do.

19 Q. Do you have S-14 there?

20 Is that a yes?

21 You read it earlier.

22 A. I have it.

23 Q. It's not unusual to see construction companies
24 bill their customers for time, materials, plus overhead;
25 correct?

1 A. Correct.

2 Q. And that overhead is often expressed as a
3 percentage; correct?

4 A. It's allocated by calculating a percentage, but
5 first you have to have all of the expenses that are
6 included in overhead, and then you apply some type of
7 ratio to it based upon a reasonable method and you come
8 up with the amount.

9 Q. Okay. So when you ask me, my construction
10 company, to build a barn, I might tell you it will be
11 time, materials, plus 36 percent. That wouldn't be a --
12 36 percent may be high, but you wouldn't be surprised
13 that I quoted you the cost to do the service in that
14 manner, would you?

15 A. Right. A 36 percent would be profit, normally.

16 Q. Well, no, I said time and materials, okay, and a
17 percentage on top of that that I called overhead.
18 Wouldn't overhead include the cost of running my office,
19 my salaries and wages, my taxes, my benefits, my
20 insurance, my postage and freight? But I have to recover
21 that somehow, don't I?

22 A. You would first have to identify the amount.

23 Q. I have to identify it for you as my customer?

24 A. If as your customer I have a right-to-audit
25 clause in your contract, yes, you would.

1 Q. You asked me to come out and do a job, and I bid
2 it at \$100,000 plus 18 percent. You would then ask me to
3 tell you what the 18 percent included?

4 A. I could.

5 Q. Okay. I could say I'm not going to build the
6 job.

7 A. That's your prerogative.

8 Q. You're not surprised that's how construction
9 companies bill their customers, are you?

10 A. I would -- I am surprised that a contractor
11 would include an amount for its overhead and profit in
12 the same percentage.

13 Q. Okay. So you would suggest -- you're suggesting
14 a construction company would bill time, material, plus
15 overhead, plus profit? They would separate overhead and
16 profit?

17 A. Exactly.

18 Q. But they would still expect to collect some
19 portion of their overhead cost from each job they do,
20 wouldn't they?

21 A. Yes.

22 Q. Otherwise, they're not going to collect it?
23 They're not going to be able to pay their bills?

24 A. That's right.

25 Q. In fact, the invoice attached to S-14 shows the

1 cost of time and materials plus 18.5 percent; correct?

2 A. That's correct.

3 Q. And again, I think you answered this, but again,
4 you assume in addition to overhead some profit would be
5 expected to be recovered in most cases; correct?

6 A. Correct.

7 Q. So this is generally how we would expect to see
8 construction companies operate. Does that change simply
9 because the construction company is affiliated with its
10 customer?

11 A. Yes, it does.

12 Q. And can you cite me some standard, some rule,
13 anything more than staff's opinion in this case that
14 supports that?

15 A. No. It's not just staff's opinion.

16 Q. Then can you point me to something that sets
17 that as a standard?

18 A. I can give you an example. With the Internal
19 Revenue Service, when the parent company files -- well,
20 let me back up.

21 If Far West's parent were a publicly traded
22 company --

23 Q. Is Far West's parent publicly traded?

24 A. If Far West's parent company were a publicly
25 traded company, then it would have to file consolidated

1 financial statements, and the reason for that is to
2 eliminate any intercompany profits.

3 The reason one would want intercompany profits
4 to be eliminated is that a company could set their income
5 or loss at will. They could move profits -- if a company
6 decided they wanted to be -- not pay any income taxes,
7 they could move all their profits to an affiliated
8 company. Or if the company decided it wanted to be
9 profitable in a given year for its income tax -- well,
10 for its SEC filing purposes, it could move profit from --
11 it could buy and sell between a particular company and
12 say, oh, our profit with this company was 500 percent and
13 report that profit.

14 For SEC purposes, all intercompany profits must
15 be eliminated, and you have to look at the company as a
16 whole.

17 Q. The IRS tells you to eliminate intercompany
18 overhead too?

19 A. Intercompany profit.

20 Q. But you removed overhead as well as profit,
21 didn't you?

22 A. I removed intercompany profit. The company did
23 not have any overhead.

24 Q. Which company?

25 A. H & S Developers did not have overhead.

1 Q. Ms. Brown, are you testifying before this
2 Commission that H & S Developers does not incur postage
3 and freight, insurance, benefits, taxes, salaries and
4 wages for the costs of running an office? Is that your
5 testimony?

6 A. My testimony is that the company had those
7 costs, and they included them in their operating
8 expenses.

9 Q. Whose operating expenses?

10 A. Far West's operating expenses.

11 Q. So it's your testimony that H & S included its
12 operating expenses in Far West's operating expenses?

13 A. That's exactly right. You hit the nail right on
14 the head. They are trying to or they have allowed the
15 regulated company to subsidize the unregulated company.

16 Q. How did they do that, Ms. Brown? Do they have
17 separate offices?

18 A. They did that by -- well, okay. They're
19 attempting to do that by increasing the rate base
20 artificially and having customers to pay a rate of return
21 on that artificially inflated rate base.

22 Q. And it's artificially inflated by including
23 H & S's operating expenses in Far West's operating
24 expenses?

25 A. H & S and Far West are the same company. And

1 that business arrangement in and of itself is not
2 economically efficient. It's a -- it's just a construct
3 to allow the company to add one more layer of created
4 costs.

5 Q. Which came first, H & S or Far West?

6 A. H & S.

7 Q. Didn't the Commission order them to separate and
8 have the sewer and water provider be regulated?

9 A. Yes. But it didn't authorize them or instruct
10 them to charge that extra layer of profit.

11 Q. Well, do we not agree that extra layer you're
12 talking about is overhead and profit?

13 A. It was not overhead. It was strictly profit.

14 Q. Okay. So let me ask you the question I asked
15 you earlier. How did -- let's look at the job that's
16 attached to S-14, okay? We've agreed that H & S
17 Developers as a company incurs the kinds of overhead
18 expenses that we expect a construction company to incur;
19 right?

20 A. Right.

21 Q. Then let's look at the invoice attached to S-14,
22 okay? Tell me how they're recovering those costs --

23 A. Okay.

24 Q. -- from this job.

25 A. In Exhibit S-33 --

1 Q. Ms. Brown, again, I asked you a specific
2 question about S-14. This is your exhibit. Can you
3 answer my question first, please? Tell me in this
4 pricing where there is a provision for recovery of
5 H & S's overhead.

6 A. H & S expensed their overhead. They allocated
7 all the overhead to Far West. Therefore, they didn't
8 have any, so they didn't report it here. So all that is
9 strictly profit.

10 Q. So it's your testimony that but for H & S's --
11 the only purpose of H & S's existence is to build plant
12 for Far West. Is that your testimony?

13 A. The only purpose of H & S to charge this 18 and
14 a half percent is to circumvent the rate-of-return
15 process and to increase its return on equity. That's my
16 testimony.

17 Q. Ms. Brown, that's not my question. My question
18 was, is it your testimony that H & S exists for the sole
19 purpose of building plant for Far West?

20 A. No.

21 Q. It has other things that it does unrelated to
22 Far West; correct?

23 A. Far West exists solely to facilitate H & S
24 Developers' sales of new homes for H & S.

25 THE WITNESS: Excuse me. What did I just say?

1 What did I just say?

2 Could you read back what I said?

3 ALJ WOLFE: Yes.

4 (Record read by the reporter.)

5 THE WITNESS: That is what I wanted to say.

6 Q. (BY MR. SHAPIRO) So Far West doesn't exist to
7 provide sewer service to customers under Commission
8 regulation?

9 A. In order to sell homes, H & S Developers had to
10 have a utility company.

11 Q. Okay. So when a developer comes to Far West and
12 its CC&N and says I would like you to extend service to
13 my development, an unaffiliated developer, Ms. Capestro
14 can tell that developer, I'm sorry, I don't need to serve
15 you, because I'm only here to serve H & S's developments,
16 that's the sole purpose for my existence, that would be
17 okay with staff?

18 A. H & S Developers would not -- Far West would not
19 exist but for H & S Developers' sales of homes.

20 Q. But it exists now, Ms. Brown, doesn't it?

21 A. Because they had to sell that dirt.

22 Q. Okay. Is there something insidious in forming a
23 utility company to facilitate development? Is that
24 illegal or evil?

25 A. I would think not.

1 Q. Okay. So then why do you keep referring to that
2 as if something wrong was being done by forming a utility
3 company to facilitate development?

4 A. I believe you asked me the question, you know,
5 what the sole purpose for Far West -- H & S is the sole
6 purpose for Far West.

7 Q. So if H & S were to build you a barn, it would
8 be okay to collect overhead and profit from you?

9 A. That would be an independent, third-party, arms'
10 length, opposing-party transaction, and it would be okay.

11 Q. Okay. And when Far West builds plant -- I'm
12 sorry, when H & S builds plant for Far West, it's not
13 okay to collect that same overhead and profit?

14 A. Exactly right, because they're one and the same
15 company.

16 Q. So they're not entitled to collect some portion
17 of the group medical insurance that they pay for their
18 employees at H & S through every job they do,
19 irrespective of who the job is for?

20 A. That's not correct. They included that cost in
21 the salaries they charged or allocated to Far West Sewer.

22 Q. Well --

23 MR. SHAPIRO: Wait a minute, Your Honor.

24 Q. (BY MR. SHAPIRO) What salaries are you speaking
25 of that were allocated?

1 A. Well, I tried to tell you, but you said, oh, no,
2 answer this other question.

3 Q. Okay.

4 A. In Exhibit S-33 that I was trying to get to --
5 yes, in Exhibit S-33, this is RUCO's fourth set, and it
6 is 4.01-C. It shows the allocation of all of the
7 employees and officers of Far West, and if you look on
8 4.02-B, it shows Sandra Braden's annual salary of
9 \$50,000, and it shows that 20 percent of Sandra Braden's
10 salary was allocated to Far West Sewer; Paula Capestro's,
11 20 percent of \$50,000.

12 Q. Isn't that her salary for working for Far West
13 utility company? That's not her salary for H & S, is
14 it? And if so, what evidence do you have to support
15 that?

16 A. Okay. If you look at note 1, it says:
17 Management has determined that 20 percent of officer
18 salary should be allocated to the sewer company.

19 Now, I believe RUCO asked, give me all the
20 support. I believe staff asked for the support for that
21 20 percent. There was no study done. There was
22 nothing. It's just an arbitrary percentage.

23 Q. Ms. Brown, let me stop you there. Isn't this an
24 allocation of the costs that are incurred by the water
25 and sewer division between those two divisions? Isn't

1 that exactly what you just said?

2 A. This is -- where it says officer's name,
3 officers, Sandra Braden, Paula Capestro, Dorothy
4 Sheckerd, James Dusty Thomas -- do you see that?

5 Q. Yes.

6 A. You see on note one, management has determined
7 that 20 percent of officers' salaries should be allocated
8 to the core company, isn't this an arbitrary percentage?

9 Q. Well, Ms. Brown, isn't this allocating 20
10 percent of Ms. Braden's salary of --

11 A. It --

12 (Discussion off the record.)

13 Q. (BY MR. SHAPIRO) Let's take it this way. Let's
14 look at the same page. Ms. Braden has a salary of
15 50,000. We can agree on that?

16 A. We can agree on that.

17 Q. That's a salary paid by Far West; correct?

18 A. That is -- from what I understand, that is the
19 portion of the salary that's allocated to Far West.

20 Q. That's the salary that Far West pays Ms. Braden
21 on an annual basis; correct?

22 A. Oh, I thought it was just her salary that she
23 got from --

24 Q. Is it possible you're wrong? Is it possible she
25 received another salary from H & S?

1 A. It says -- this is a data request. It says
2 4.02. It says list amount of salaries allocated to Far
3 West Sewer.

4 Q. Okay. Does it say list the amount of salaries
5 paid to H & S employees and officers that are allocated
6 to Far West Sewer?

7 A. No.

8 Q. Is it possible you made a mistake in your
9 analysis here, Ms. Brown, and you're just realizing it
10 now?

11 A. Well, it's -- the point is -- my point in
12 bringing this out is that there was no study to determine
13 what any of these officers did for Far West Sewer.

14 Q. You -- I'm sorry.

15 A. It was not based upon any study. All the
16 company provided for the basis of these amounts being
17 allocated to Far West is just an arbitrary percentage.

18 Q. Ms. Brown --

19 A. It is staff's determination that because the
20 company could not provide us with any supporting
21 documentation for any of their overhead expenses that
22 these costs include any time that these officers spent on
23 any H & S construction projects.

24 Q. So you assumed that this \$50,000 that was paid
25 by Far West to Ms. Braden paid her to work for H & S?

1 You made that assumption; is that your testimony?

2 A. Repeat that.

3 Q. Yes. I'll have it read back.

4 (Record was read by the reporter.)

5 THE WITNESS: That question needs to be
6 rephrased.

7 Q. (BY MR. SHAPIRO) Okay. Why don't we try it
8 this way. Show me in your schedules where you made an
9 adjustment to salaries and wages in Far West's income
10 statement because you felt that these numbers were
11 unsupported.

12 A. I didn't -- I did not say these numbers were
13 unsupported. I said that the overhead, the claimed
14 overhead that the company wants to include in rate base
15 cannot be supported.

16 Q. Let me hand you what's been marked as Exhibit
17 A-9. This is attached to Mr. Bourassa's rebuttal
18 testimony as well. This is an H & S Developers statement
19 of income for the years 2002 through 2005.

20 Do you have that document?

21 A. Yes.

22 Q. Mr. Bourassa attached this document to his
23 rebuttal testimony?

24 A. I don't know.

25 Q. Well, okay. You didn't look at this document

1 before? You've never seen this?

2 A. I looked at hundreds, possibly thousands of
3 documents. I don't particularly recall this one.

4 Q. So when you say that Far West has no
5 information -- I'm sorry -- H & S has no information to
6 support that it ever incurred overhead costs, you don't
7 recall seeing this document?

8 A. Supporting documents would entail sufficient
9 competent information. That would not include a
10 documentation that was created by the company itself. It
11 would have to be documents such as signed time sheets,
12 materials purchased from a third party.

13 Q. So in order for -- let me make sure I understand
14 this. In order for H & S Developers to justify charging
15 overhead on projects it builds for Far West, H & S
16 Developers must provide you with all of its employees'
17 time sheets, with receipts for payments of group medical,
18 workman's comp, employee benefits, advertising and
19 promotion, rent, utilities; otherwise, they can't charge
20 overhead?

21 A. That's correct.

22 Q. Did you ask for that stuff?

23 A. It is a third -- yes.

24 Q. And Mr. Bourassa provided this document as part
25 of his testimony, correct, which summarizes all of the

1 amounts incurred by H & S; correct?

2 A. This is the company's claim. It has not been
3 audited. The company's financial statements are not
4 audited by an independent auditing firm.

5 Q. But Ms. Brown, let's go to the test year. Did
6 H & S Developers charge Far West \$149,656 for salaries?

7 A. Where do you get that number?

8 Q. It's the first number in the column 2004 in
9 Exhibit A-9.

10 MR. LAYTON: Your Honor?

11 ALJ WOLFE: Mr. Layton?

12 MR. LAYTON: When Ms. Brown finishes answering
13 Mr. Shapiro's question, I have a housekeeping matter.

14 ALJ WOLFE: Okay.

15 THE WITNESS: I can only tell you what Far West
16 reported as salaries and wages in its income statement,
17 and it was \$401,131.

18 Q. (BY MR. SHAPIRO) And you didn't make any
19 adjustment to that number?

20 A. No.

21 Q. And you would agree with me, we can presume,
22 that H & S Developers incurred certain expenses that
23 qualify or come under the categorization of overhead?

24 A. See, that's the problem with your whole line of
25 thinking. Far West and H & S are one and the same

1 company. They're owned by the same people. A company
2 cannot earn a profit buying and selling from itself.
3 It's merely moving resources around.

4 Q. So, again, Far West didn't incur the cost of
5 utilities for its office -- I mean, H & S did not incur
6 the costs of utilities for its office?

7 A. It was utilizing resources that it needed to
8 provide service to the -- to its customers.

9 Q. Let's go back to your testimony at the beginning
10 of your direct when you referred to Exhibit S-14.

11 ALJ WOLFE: Excuse me, Mr. Shapiro. Mr. Layton
12 asked for --

13 MR. LAYTON: Your Honor, it looks like we're
14 probably going to go until five o'clock at this point.

15 MR. SHAPIRO: I don't think so. I have five
16 minutes, just so we're clear.

17 MR. LAYTON: Okay.

18 MR. POZEFSKY: Your Honor, while we are doing
19 housekeeping matters, I thought I would ask you -- I know
20 where this is going. Mrs. Brown has said something that
21 is not in her testimony, and had it been, I would have,
22 of course, had some cross-examination.

23 I didn't have any questions before, but I was
24 wondering if Your Honor would give me a little leeway to
25 ask just a few questions after, and this way, so it

1 doesn't prejudice staff, they, of course, can address it
2 on redirect if it's anything significant. If that would
3 be possible. I don't think it would be unfair to
4 anybody.

5 ALJ WOLFE: Is this in regard to the RUCO
6 exhibit that she referred to in her answer?

7 MR. POZEFSKY: No, it's in regard to something
8 she said earlier in response to a question Mr. Shapiro
9 asked. Again, it's not in her testimony. It affects one
10 of our positions. So I didn't have an opportunity to
11 address it.

12 ALJ WOLFE: It affects RUCO's position? Is that
13 what you just said?

14 MR. POZEFSKY: Yeah.

15 ALJ WOLFE: We'll do that after Mr. Shapiro is
16 finished with his questions.

17 Q. (BY MR. SHAPIRO) Let's go back to S-14. You
18 said the reason you made your adjustment to remove
19 \$147,000 from rate base was because of this statement in
20 Exhibit S-14; correct?

21 A. The entire S-14, the amounts that are listed as
22 affiliate profit.

23 Q. Show me on the bill from H & S Developers to Far
24 West Sewer where the word "profit" is shown.

25 A. Well, I can show you on another one.

1 Q. Show me on Exhibit S-14 that you just said was
2 the entire basis for your adjustment where the word
3 "profit" is.

4 A. That's not my entire basis.

5 Q. So you're changing your testimony?

6 A. Yes, I am. I looked at a number of documents to
7 come up with staff's conclusion.

8 Q. So when you said earlier in your direct
9 testimony in response to Mr. Layton that developers --
10 H & S Developers does not keep detailed job-costing
11 records for its labor and equipment, that that was the
12 basis for your adjustment --

13 A. That was one of the bases.

14 Q. One of the bases. Thank you.

15 Isn't it possible that all that statement means
16 is that H & S does not allocate a portion of its costs
17 for group medical on a specific job-by-job basis to Far
18 West when it builds plant?

19 Sorry. Am I bothering you, Ms. Brown, by asking
20 you these questions?

21 A. Far West and H & S are one and the same
22 company. They do not need to allocate an additional
23 amount to Far West when it has already included those
24 expenses in the salaries that it pays to its officers and
25 employees.

1 ALJ WOLFE: Mr. Shapiro, I will admonish you not
2 to be argumentative with the witness.

3 MR. SHAPIRO: Yes. I'm sorry, Your Honor. I
4 apologize.

5 Q. (BY MR. SHAPIRO) Does Far West have the same
6 employees as H & S?

7 A. They have a lot of the same. They're all the
8 same company. They all contribute to the owner's
9 profit. That's why they're in business.

10 Q. So when Mr. Irvine did his cost of capital, he
11 included all the debt and equity on H & S Developers'
12 books in Far West's books and records?

13 A. I'm not really sure. I try to stay away from
14 cost of capital.

15 Q. You included all the salaries and wages paid to
16 H & S Developers' employees in Far West's income
17 statement because they're one and the same company;
18 right?

19 A. Repeat that question?

20 Q. Yes. You included all of the -- let me try it
21 this way.

22 You included all of H & S Developers' expenses
23 in Far West Sewer's income statement in this case because
24 they're one and the same company; right?

25 A. What I did was to observe that there is no

1 economically efficient -- I'm sorry, economic efficient
2 reason for H & S to charge a layer of profit on its
3 regulated affiliate.

4 Q. Let me hand you what has been marked as Exhibit
5 A-10. This is staff's response to the company's data
6 request 1.7, is it not?

7 A. Yes, it is.

8 Q. We asked you what staff did to determine if the
9 costs incurred by the company for affiliate profit were
10 reasonable and prudent, didn't we?

11 A. Yes, you did.

12 Q. Now, you said that the first thing you
13 considered was whether or not the affiliate performed the
14 same services for unaffiliated companies; correct?

15 A. Correct.

16 Q. Now, the answer to that, based on Ms. Capestro's
17 testimony here, is that they do perform those same
18 services for unaffiliated entities; right?

19 A. I would like to see that. Do you know where
20 that --

21 Q. Well, Ms. Brown, you don't know that she
22 testified to that?

23 A. That's why I'm asking you to see it.

24 Q. Well, I would be happy to recall her as a
25 rebuttal witness, but I will state for the record that

1 was her testimony. If Mr. Layton disagrees, he can
2 object.

3 When you did your analysis that you identified
4 in 1.7 did you assume that they didn't perform the same
5 services for unaffiliated companies?

6 A. I assumed that.

7 Q. Okay. You didn't ask the company one way or
8 another, did you?

9 A. Let me check something.

10 Yes, I did.

11 Q. You did ask the company that?

12 A. Yes, I did.

13 Q. What did the company tell you?

14 A. I would have to go pull the data request.

15 Q. As you sit here today, you don't know; correct?

16 A. I don't recall.

17 Q. Okay. The second thing you consider is whether
18 or not competitive bids were obtained, and we all agree
19 that they were not obtained; correct?

20 A. Correct.

21 Q. The next thing you look at is the reasons for
22 not obtaining competitive bids; correct?

23 A. Correct.

24 Q. What were the reasons that the company didn't
25 obtain competitive bids that you were aware of?

1 A. I could go pull the data request if you're
2 really seriously interested.

3 Q. So you don't know again as we sit here --

4 A. I could go get it. Do you really want it? I
5 could go get it.

6 Q. I guess, Ms. Brown, is it going to be your
7 answer for each of these that you don't know as you sit
8 here today testifying --

9 A. I'm telling you --

10 Q. I get to finish my question. Make it much
11 easier for the court reporter.

12 Are you testifying as you sit here today you
13 can't explain the analysis that you identified you did in
14 Exhibit 1.7 -- I'm sorry, Exhibit A-10?

15 A. I'm saying, if I pulled the company's data
16 request response, then I could give you the answer you
17 are looking for.

18 Q. That wasn't my question. My question was, are
19 you testifying that you can't do it as you sit here
20 testifying in this case right now?

21 A. Without my data request response.

22 MR. SHAPIRO: Your Honor, I'll move for the
23 admission of Exhibit A-8, A-9 and A-10.

24 MR. POZEFSKY: I believe A-9 is already in
25 evidence according to the company's prior testimony.

1 ALJ WOLFE: Are you objecting to having it
2 marked as an exhibit?

3 MR. SHAPIRO: We just offered it because we
4 thought it would be simpler.

5 MR. POZEFSKY: No.

6 ALJ WOLFE: Are there any objections to A-8,
7 A-9, or A-10?

8 MR. LAYTON: No, Your Honor.

9 ALJ WOLFE: A-8, A-9, and A-10 are admitted.

10 (Exhibits A-8, A-9, and A-10 were admitted into
11 evidence.)

12 MR. SHAPIRO: Thank you.

13 ALJ WOLFE: Mr. Layton, did you want to address
14 your housekeeping issue before Mr. Pozefsky has his
15 questions for the witness?

16 MR. LAYTON: No, Your Honor. We have no
17 redirect.

18 ALJ WOLFE: Okay. You may after Mr. Pozefsky.

19 MR. POZEFSKY: I just have a few, Your Honor.

20

21 CROSS-EXAMINATION

22

23 Q. (BY MR. POZEFSKY) Ms. Brown, I thought -- and
24 correct me if I'm wrong, but did I hear you say in
25 response to a question Mr. Shapiro asked -- did you say

1 the property tax expense will -- excuse me, the
2 overcollection of the property tax expense will offset
3 the repair expense deficiency? Is that what I thought
4 I --

5 A. Repeat what you said.

6 Q. In response to a question that Mr. Shapiro asked
7 you regarding the repair expense, did I hear you say that
8 the overcollection of the property tax expense will
9 offset the repair expense deficiency?

10 A. I didn't use the word "overcollection." What I
11 said was -- if I could just clarify. He asked a
12 hypothetical, if the company's repair and maintenance
13 expense exceeded the amount that was in the test year by
14 30,000, would the company have to come in for rates for
15 the 30,000, and what I intended to say was the company
16 does not -- the revenue requirement is not consisting of
17 just one item. It's several items.

18 There is all kinds of economic influences going
19 on. The property tax, the actual property tax for the
20 company, the year after rates are approved, may be
21 different than what -- may be less than what was allowed,
22 and those two items could offset.

23 Q. But you believe that the methodology being
24 adopted or recommended by staff is the more accurate way
25 to measure property tax expense in the future than what

1 is being recommended by RUCO; correct?

2 A. I believe staff's methodology is the correct
3 methodology.

4 MR. POZEFSKY: All I have. Thank you.

5 ALJ WOLFE: Thank you, Mr. Pozefsky.

6 Mr. Layton, did you want to ask questions of
7 this witness regarding these exhibits regarding
8 affiliates? I just want to make sure that you have the
9 opportunity to do that if you'd like to.

10 MR. LAYTON: No, Your Honor. We're finished.

11 ALJ WOLFE: Okay. Thank you.

12 Thank you for your testimony, Ms. Brown.

13 THE WITNESS: Thank you.

14 ALJ WOLFE: You're excused as a witness.

15 Let's take a ten-minute break. We'll come back
16 and talk about briefs, et cetera.

17 (Recess at 3:56 p.m.; resumed at 4:10 p.m.)

18 (Discussion off the record.)

19 ALJ WOLFE: Let's go back on the record.

20 There was a discussion about the filing of final
21 schedules and the briefing schedules that the parties had
22 mentioned before. The final schedules will include
23 revenue requirement schedules, rate-base schedules,
24 operating income statement schedule, a rate-design
25 schedule, and for the company, rate-case expense

1 itemization. And the company has stated that it can file
2 that by August 15, so we'll expect that to be filed
3 August 15 and provided to the other parties.

4 RUCO and staff will file their final schedules
5 on August 29. If there is a problem with being able to
6 meet that time frame, parties can request a procedural
7 conference to discuss that.

8 Closing briefs will be filed simultaneously by
9 all parties on September 8, and reply briefs will be
10 filed simultaneously by all parties on September 29.

11 Just for the record, I don't show any
12 outstanding late-filed exhibits.

13 MR. SHAPIRO: Except for A-7, which will be
14 filed late but has been admitted; correct?

15 ALJ WOLFE: Correct. That's the late-filed
16 exhibit of Far West Water and Sewer, Inc.'s, wastewater
17 treatment plant capacity analysis.

18 Are there any other procedural matters that need
19 to be addressed?

20 MR. SHAPIRO: Not from the company.

21 ALJ WOLFE: Then thank you very much for your
22 participation in this proceeding. I will take this
23 matter under advisement upon receipt of the reply briefs
24 filed on September 29, 2006, and prepare a recommended
25 opinion and order for the Commission's final

1 disposition.

2 (Proceedings concluded at 4:12 p.m.)

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1 STATE OF ARIZONA)
2 COUNTY OF MARICOPA) ss.

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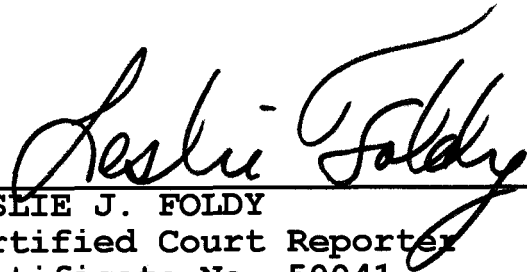
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I, LESLIE J. FOLDY, Certified Court
Reporter No. 50041 for the State of Arizona, do hereby
certify that the foregoing printed pages constitute a
full, true and accurate transcript of the proceedings had
in the foregoing matter, all done to the best of my skill
and ability.

WITNESS my hand this 2nd day
of August, 2006.



LESLIE J. FOLDY
Certified Court Reporter
Certificate No. 50041